

# MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE THREE AND NINE MONTHS  
ENDED SEPTEMBER 30, 2020



**HIGH MARGINS**  
**ZERO CAPITAL**

## Management's Discussion and Analysis

*This Management's Discussion and Analysis ("MD&A") for PrairieSky Royalty Ltd. ("PrairieSky" or the "Company") should be read in conjunction with the unaudited interim condensed consolidated financial statements as at and for the three and nine months ended September 30, 2020 and 2019 ("interim condensed consolidated financial statements") and the audited consolidated financial statements and related notes as at and for the years ended December 31, 2019 and 2018. This MD&A has been prepared as of October 26, 2020.*

*The unaudited interim condensed consolidated financial statements and comparative information have been prepared in Canadian dollars and in accordance with International Accounting Standard ("IAS") 34, "Interim Financial Reporting" as issued by the International Accounting Standards Board ("IASB"). PrairieSky receives royalty income on production; as such, the production volumes are equivalent on a gross and net basis.*

*Certain measures in this document do not have any standardized meaning as prescribed by IFRS and, therefore, are considered non-GAAP measures. Non-GAAP measures are commonly used in the oil and gas industry and by PrairieSky to provide potential investors with additional information regarding the Company's liquidity and its ability to generate funds to conduct its business. Non-GAAP measures include Operating Netback, Operating Netback per BOE, Cash Administrative Expenses, and Cash Administrative Expenses per BOE. Further information can be found in the Non-GAAP Measures section of this MD&A.*

*The following volumetric measures may be abbreviated throughout this MD&A: barrel ("bbl") per day ("bbls/d"), barrel of oil equivalent ("BOE") per day ("BOE/d"), thousand cubic feet ("Mcf"), and million cubic feet ("MMcf") per day ("MMcf/d"). BOE is an industry measurement to summarize the amount of energy equivalent found in a barrel of crude oil. See the discussion on energy conversions in the Advisory section of this MD&A for further explanation.*

**Readers should also read the Advisory section located at the end of this MD&A, which provides information on Forward-Looking Statements, oil, natural gas and natural gas liquids ("NGL") conversions, currency and references to PrairieSky.**

## FINANCIAL AND OPERATIONAL RESULTS

(millions, except per share or as otherwise noted)	Three months ended September 30		Nine months ended September 30	
	2020	2019	2020	2019
<b>FINANCIAL</b>				
Revenues	\$ 43.5	\$ 58.8	\$ 124.4	\$ 201.3
Funds from Operations	37.9	48.8	105.7	164.6
Per Share – basic and diluted <sup>(1)</sup>	0.16	0.21	0.46	0.70
Net Earnings	9.4	16.7	17.6	87.1
Per Share - basic and diluted <sup>(1)</sup>	0.04	0.07	0.08	0.37
Dividends declared <sup>(2)</sup>	13.4	45.5	72.7	136.7
Per Share	0.0600	0.1950	0.3150	0.5850
Common share repurchases	81.8	4.2	90.9	16.2
Acquisitions, including non-cash consideration	-	5.2	6.7	7.8
Working Capital (Deficiency) at period end	(66.2)	(7.4)	(66.2)	(7.4)
Shares outstanding				
Shares outstanding at period end	223.3	233.3	223.3	233.3
Weighted average - basic	229.8	233.4	231.7	233.7
Weighted average - diluted	230.2	233.8	232.2	234.1
<b>OPERATIONAL</b>				
<b>Royalty Production Volumes</b>				
Crude Oil (bbls/d)	6,572	8,011	7,061	8,548
NGL (bbls/d)	2,473	2,334	2,667	2,536
Natural Gas (MMcf/d)	58.2	61.0	60.7	63.1
Royalty Production (BOE/d) <sup>(3)</sup>	18,745	20,512	19,845	21,601
<b>Realized Pricing</b>				
Crude Oil (\$/bbl)	41.11	59.04	36.82	60.79
NGL (\$/bbl)	21.43	20.23	21.92	28.81
Natural Gas (\$/Mcf)	1.62	0.72	1.52	1.14
Total (\$/BOE) <sup>(3)</sup>	22.27	27.50	20.71	30.78
<b>Operating Netback per BOE<sup>(4)</sup></b>	<b>\$ 19.54</b>	<b>\$ 23.31</b>	<b>\$ 17.90</b>	<b>\$ 26.73</b>
<b>Funds from Operations per BOE</b>	<b>\$ 21.98</b>	<b>\$ 25.86</b>	<b>\$ 19.44</b>	<b>\$ 27.91</b>
<b>Oil Price Benchmarks</b>				
West Texas Intermediate (WTI) (US\$/bbl)	40.93	56.50	38.32	57.07
Edmonton Light Sweet (\$/bbl)	49.80	68.48	43.70	69.62
Western Canadian Select (WCS) crude oil differential to WTI (US\$/bbl)	(9.09)	(12.24)	(13.69)	(11.74)
<b>Natural Gas Price Benchmark</b>				
AECO monthly index (\$/Mcf)	2.15	1.05	2.07	1.39
AECO daily index (\$/Mcf)	2.27	0.89	2.10	1.52
Foreign Exchange Rate (US\$/CAD\$)	0.7511	0.7564	0.7393	0.7525

(1) Net Earnings and Funds from Operations per Share are calculated using the weighted average number of basic and diluted common shares outstanding.

(2) A dividend of \$0.06 per common share was declared on September 9, 2020. The dividend was paid on October 15, 2020 to shareholders of record as at September 30, 2020.

(3) See "Conversions of Natural Gas to BOE".

(4) Operating Netback per BOE is defined under the Non-GAAP Measures section in this MD&A.

## RESULTS OVERVIEW

### HIGHLIGHTS

Highlights of PrairieSky's financial results for the three months ended September 30, 2020 ("Q3 2020") include:

- Revenues totaled \$43.5 million, consisting of \$38.4 million of royalty production revenue, \$1.2 million of lease rental income, \$1.8 million of bonus consideration and \$2.1 million of other income.
- Funds from operations totaled \$37.9 million (\$0.16 per share basic and diluted).
- Royalty production averaged 18,745 BOE per day (48% liquids) consisting of average crude oil royalty production volumes of 6,572 bbls per day, average NGL royalty production volumes of 2,473 bbls per day and average natural gas royalty production volumes of 58.2 MMcf per day.
- Dividends declared of \$13.4 million (\$0.06 per share).
- Purchased for cancellation 8,866,991 common shares at a weighted average price of \$9.22 per common share for total consideration of \$81.8 million under the normal course issuer bid ("NCIB").

Highlights of PrairieSky's financial results for the nine months ended September 30, 2020 ("YTD 2020") include:

- Revenues totaled \$124.4 million, consisting of \$112.6 million of royalty production revenue, \$4.1 million of lease rental income, \$4.9 million of bonus consideration and \$2.8 million of other income.
- Funds from operations totaled \$105.7 million (\$0.46 per share basic and diluted).
- Royalty production averaged 19,845 BOE per day (49% liquids) consisting of average crude oil royalty production volumes of 7,061 bbls per day, average NGL royalty production volumes of 2,667 bbls per day and average natural gas royalty production volumes of 60.7 MMcf per day.
- Dividends declared of \$72.7 million (\$0.3150 per share).
- Purchased for cancellation 9,770,691 common shares at a weighted average price of \$9.30 per common share for total consideration of \$90.9 million under the NCIB.

## BUSINESS OVERVIEW

### PRAIRIESKY ROYALTY

PrairieSky's asset base includes a geologically and geographically diverse portfolio of Fee Lands (as defined herein) that encompasses approximately 7.8 million acres with petroleum and/or natural gas rights and approximately 7.7 million acres of GORR Lands (as defined herein) and other acreage (collectively, the "Royalty Properties").

The Royalty Properties are comprised of: (i) fee simple mineral title in lands prospective for petroleum, natural gas, NGL and other minerals located predominantly in central and southern Alberta and western Saskatchewan (the "Fee Lands"); (ii) lessor interests in and to leases that are currently issued in respect of certain Fee Lands ("Lessor Interests"); and (iii) overriding royalty interests ("GORR Interests") on lands ("GORR Lands") across Western Canada.

PrairieSky is focused on encouraging third parties to actively develop the Royalty Properties and growing our royalty ownership by strategically seeking additional royalty assets that provide PrairieSky with medium-term to long-term value enhancement potential. The Company does not directly conduct operations to explore for, develop or produce petroleum, NGL or natural gas; rather, third-party development of the Royalty Properties provides the Company with royalty production revenues as petroleum, NGL and natural gas are produced

from such properties. PrairieSky carries on business in the provinces of Alberta, Saskatchewan, British Columbia and Manitoba.

PrairieSky's operations include royalty income earned through crude oil, NGL and natural gas produced on the Royalty Properties. The Company's royalty production revenues are derived from: (i) the Lessor Interests that are leased out by the Company and upon which lessees pay lessor royalties, and (ii) GORR Interests on GORR Lands.

PrairieSky receives royalty production revenue from approximately 38,000 wells and receives payments from approximately 310 different industry payors. The Company receives approximately 75% of its monthly revenue from 30 payors. Royalties are calculated on a fixed percentage, step or sliding scale formula. Some royalty agreements allow for the deduction of certain costs. The corporate average royalty rate for all wells on production in Q3 2020 was approximately 6.0%.

Petroleum and natural gas royalty structures are typically linked directly to production volumes from the lands, with certain royalty structures linked to production volumes and/or price. As a result, the Company's net earnings can be significantly impacted by fluctuations in commodity prices and production volumes. Production volumes can be influenced by various factors, including the extent of exploration and development activity by third parties on the Royalty Properties, the timing and amount of capital expenditures and field operations, and the expertise and financial resources of third-party lessees. Commodity pricing is influenced by market supply and demand as well as other factors such as weather, quality of product, access to markets, foreign currency fluctuations, and geopolitical risk. The Company is able to mitigate some of these risks to the extent that there are a multitude of third parties actively exploring and developing the Royalty Properties and the production of natural gas, crude oil, and NGL is diversified.

As a royalty owner, PrairieSky does not bear the operational risks typically associated with the upstream petroleum and natural gas exploration and production business. The Company does not bear the operational or financial risks of drilling, completing or operating wells and related infrastructure. The Company is not responsible for site restoration and abandonment costs. Capital, operational and abandonment costs are the responsibility of the third parties conducting operations on the Royalty Properties. Substantially all the capital expenditures made by PrairieSky are discretionary.

Costs incurred by the Company are primarily production and mineral taxes, administrative expenses and corporate income taxes. Administrative expenses include lease administration costs such as land title management, contract administration, technical evaluation, negotiations and compliance costs to secure mineral rights and ensure accurate royalty revenue receipts.

Management's discussion and analysis for this reporting period focuses on the three and nine months ended September 30, 2020.

## **PRAIRIESKY'S 2020 OUTLOOK**

Management does not provide guidance. As such, this discussion relates only to general economic conditions experienced by the Company as of the date of this MD&A. The novel coronavirus (COVID-19) pandemic has significantly impacted the global economy as large-scale restrictions have been put in place to prevent its spread, creating market volatility and a dramatic decrease in global oil demand. This decrease combined with instability for crude oil pricing have impacted both cash flows in the energy industry and access to capital. Canadian oil and gas operators responded by shutting in production and reducing their capital budgets and spending. As restrictions have eased and crude oil pricing has stabilized around WTI US\$40 per barrel, certain shut-in production has gradually resumed in Q3 2020. The resumption of all shut-in volumes by year-end will be dependent on WTI pricing. Natural gas pricing has remained relatively stable which has been positive for PrairieSky, and third-party natural gas producers.

PrairieSky remains confident in its strategy and business model which provides robust operating margins in all commodity cycles. Management continues to deploy its risk mitigating strategies including proactive monitoring of economic conditions, a constant and proactive compliance and collections program, paying

close attention to controllable costs and a disciplined approach to acquisitions. PrairieSky has consistently maintained a strong balance sheet and employs a conservative capital structure.

Management continues to monitor current commodity prices, currency exchange rates, industry activity levels and third-party guidance for anticipated capital expenditures during the remainder of 2020 and beyond. Given PrairieSky has no operational control over capital expenditures on its lands, it is difficult to predict activity levels and the timing thereof with a high degree of certainty. The pace of an economic recovery is challenging to determine with the overall outlook on crude oil demand dependent on changes to social restrictions and businesses resuming regular operations with the existence of COVID-19.

PrairieSky's diversity in crude oil and natural gas plays and payors, along with an active royalty compliance program, assists in reducing collection and credit risk. The Company takes certain royalty production volumes in-kind which, in conjunction with the above processes, further assists in managing collection and credit risk.

## PRAIRIESKY'S STRATEGY

The Company's objective is to generate significant cash flow and growth for shareholders through indirect crude oil and natural gas investment at relatively low risk and low cost to the Company. The Company seeks to achieve this objective by: (i) focusing on leasing activity and organic growth of royalty production revenue from the Royalty Properties; (ii) proactively monitoring and managing the portfolio of Royalty Properties to ensure third-party adherence to lease terms and contractual provisions (including offset well obligations); (iii) managing controllable costs; and (iv) selectively pursuing strategic business development opportunities that are relatively low risk to the Company and accretive to shareholders. The Company intends to distribute the majority of cash flow in the form of dividends and share repurchases and cancellations over time.

## ROYALTY PRODUCTION

### ROYALTY PRODUCTION VOLUMES

(Average daily)	Three months ended September 30		Nine months ended September 30	
	2020	2019	2020	2019
Crude Oil (bbls/d)	6,572	8,011	7,061	8,548
NGL (bbls/d)	2,473	2,334	2,667	2,536
Natural Gas (MMcf/d)	58.2	61.0	60.7	63.1
Total Royalty Production (BOE/d)	18,745	20,512	19,845	21,601

PrairieSky's average daily royalty production volumes for Q3 2020 were 35% crude oil, 13% NGL and 52% natural gas as compared to the three months ended September 30, 2019 ("Q3 2019") when the royalty production volume split was 39% crude oil, 11% NGL and 50% natural gas. The average daily royalty production volume split for YTD 2020 was 36% oil, 13% NGL and 51% natural gas as compared to the nine months ended September 30, 2019 ("YTD 2019") when the average daily royalty production volume split was 40% crude oil, 12% NGL and 48% natural gas. There is a natural delay between the timing of production and when PrairieSky receives its royalty interest production volumes and revenue from operators. Due to this delay, positive and negative adjustments related to prior periods may be included in PrairieSky's royalty production volumes and/or revenue. PrairieSky's compliance department continually reviews leasing agreements and royalty calculations and collections related to compliance recoveries result in adjustments to royalty production volumes and royalty revenue related to prior periods. Compliance adjustments are not recorded in the financial statements until collection is certain.

PrairieSky's crude oil, NGL and natural gas production volumes are primarily marketed with lessees' production. The Company actively reviews its counterparties and takes certain royalty volumes in-kind to mitigate credit risk, as appropriate. PrairieSky is exposed to commodity price volatility. The Company has no commodity price hedges in place and does not currently intend to enter into any commodity price hedges.

## For the three months ended September 30, 2020

Crude oil royalty production volumes for Q3 2020 of 6,572 bbls per day have decreased 18% from 8,011 bbls per day reported in Q3 2019. During Q2 2020, third-party operators across Western Canada shut-in production in response to the significant decrease in WTI benchmark pricing due to global demand deterioration as a result of COVID-19. Third-party operators have started to bring previously shut-in production back on through Q3 2020. Lower benchmark pricing also negatively impacted sliding scale royalty volumes.

NGL royalty production volumes for Q3 2020 of 2,473 bbls per day have increased 6% from 2,334 bbls per day reported in Q3 2019 as prior period adjustments increased production during Q3 2020.

Natural gas royalty production volumes for Q3 2020 of 58.2 MMcf per day were 5% lower than the 61.0 MMcf per day reported in Q3 2019 as natural declines and lower solution gas volumes from oil wells offset incremental production from new wells.

## For the nine months ended September 30, 2020

Crude oil royalty production volumes for YTD 2020 of 7,061 bbls per day decreased 17% from 8,548 bbls per day reported in YTD 2019 primarily due to production shut-ins across Western Canada as noted above as well as due to the negative impact to sliding scale royalty volumes from the significant decrease in WTI benchmark pricing. Overall drilling and workover activity across Western Canada was down year over year which has also impacted oil royalty production.

NGL royalty production volumes for YTD 2020 of 2,667 bbls per day have increased 5% from 2,536 bbls per day reported in YTD 2019 as royalty production volumes from new drilling on the Royalty Properties outweighed natural declines. NGL production increased despite natural gas production volume declines due to increased yields from liquids rich natural gas production.

Natural gas royalty production volumes for YTD 2020 of 60.7 MMcf per day decreased 4% from 63.1 MMcf per day reported in YTD 2019 as royalty production volumes from new drilling on the Royalty Properties were outweighed by natural declines and the impact of lower solution gas volumes from shut-in oil production.

## FINANCIAL RESULTS

### OPERATING RESULTS

	Three months ended September 30, 2020		Three months ended September 30, 2019	
	(\$ millions)	(\$/BOE) <sup>(2)</sup>	(\$ millions)	(\$/BOE) <sup>(2)</sup>
Royalty Production Revenue	\$ 38.4	\$ 22.27	\$ 51.9	\$ 27.50
Administrative Expenses	(4.1)	(2.38)	(6.7)	(3.55)
Production and Mineral Taxes	(0.6)	(0.35)	(1.2)	(0.64)
Operating Netback <sup>(1)</sup>	\$ 33.7	\$ 19.54	\$ 44.0	\$ 23.31

(1) Non-GAAP measure. See "Non-GAAP Measures" in this MD&A.

(2) See "Conversions of Natural Gas to BOE".

	Nine months ended September 30, 2020		Nine months ended September 30, 2019	
	(\$ millions)	(\$/BOE) <sup>(2)</sup>	(\$ millions)	(\$/BOE) <sup>(2)</sup>
Royalty Production Revenue	\$ 112.6	\$ 20.71	\$ 181.5	\$ 30.78
Administrative Expenses	(13.7)	(2.52)	(20.6)	(3.49)
Production and Mineral Taxes	(1.6)	(0.29)	(3.3)	(0.56)
Operating Netback <sup>(1)</sup>	\$ 97.3	\$ 17.90	\$ 157.6	\$ 26.73

(1) Non-GAAP measure. See "Non-GAAP Measures" in this MD&A.

(2) See "Conversions of Natural Gas to BOE".

The Q3 2020 operating netback of \$33.7 million (\$19.54 per BOE) has decreased 23% from \$44.0 million (\$23.31 per BOE) in Q3 2019 primarily as a result of lower royalty production revenue and specifically lower benchmark pricing and production volumes for crude oil.

The YTD 2020 operating netback of \$97.3 million (\$17.90 per BOE) has decreased 38% from \$157.6 million (\$26.73 per BOE) in YTD 2019 primarily as a result of lower royalty production revenue and specifically lower benchmark pricing and production volumes from crude oil.

## REVENUES

(\$ millions)	Three months ended September 30		Nine months ended September 30	
	2020	2019	2020	2019
<b>Royalty Production Revenue by Product</b>				
Crude Oil	\$ 24.8	\$ 43.4	\$ 71.2	\$ 141.8
NGL	4.9	4.4	16.0	20.0
Natural Gas	8.7	4.1	25.4	19.7
	38.4	51.9	112.6	181.5
<b>Other Revenue</b>				
Lease Rental Income	\$ 1.2	\$ 1.2	\$ 4.1	\$ 5.0
Bonus Consideration	1.8	4.4	4.9	10.7
Other Income	2.1	1.3	2.8	4.1
	5.1	6.9	11.8	\$ 19.8
<b>Total Revenue</b>	<b>\$ 43.5</b>	<b>\$ 58.8</b>	<b>\$ 124.4</b>	<b>\$ 201.3</b>

(\$ millions)	Three months ended September 30		Nine months ended September 30	
	2020	2019	2020	2019
<b>Revenues by Classification</b>				
Lessor Interests on Fee Lands	\$ 24.9	\$ 34.6	\$ 70.5	\$ 120.1
GORR Interests	13.5	17.3	42.1	61.4
Royalty Production Revenue	38.4	51.9	112.6	181.5
Other Revenue	5.1	6.9	11.8	19.8
<b>Total Revenue</b>	<b>\$ 43.5</b>	<b>\$ 58.8</b>	<b>\$ 124.4</b>	<b>\$ 201.3</b>

<b>Pricing</b>	Three months ended September 30		Nine months ended September 30	
	2020	2019	2020	2019
<b>Benchmark</b>				
WTI (US\$/bbl)	40.93	56.50	38.32	57.07
Edmonton Light Sweet (\$/bbl)	49.80	68.48	43.70	69.62
WCS Differential to WTI (US\$/bbl)	(9.09)	(12.24)	(13.69)	(11.74)
AECO Monthly Index (\$/Mcf)	2.15	1.05	2.07	1.39
AECO Daily Index (\$/Mcf)	2.27	0.89	2.10	1.52
Foreign Exchange Rate (US\$/CAD\$)	0.7511	0.7564	0.7393	0.7525

Realized Pricing	Three months ended September 30		Nine months ended September 30	
	2020	2019	2020	2019
Crude Oil (\$/bbl)	41.11	59.04	36.82	60.79
NGL (\$/bbl)	21.43	20.23	21.92	28.81
Natural Gas (\$/Mcf)	1.62	0.72	1.52	1.14
<b>Total (\$/BOE)</b>	<b>22.27</b>	<b>27.50</b>	<b>20.71</b>	<b>30.78</b>

The Company's average royalty rate for all wells on production in Q3 2020 and Q3 2019 was approximately 6.0%. During Q3 2020, royalty production revenue was \$38.4 million compared to \$51.9 million for the same period in 2019, a decrease of 26%. The decrease in royalty production revenue was primarily due to the 28% decrease in WTI benchmark pricing between the two quarters. The significant decrease in pricing also resulted in third-party operators shutting in production which lowered the Company's royalty production volumes.

During Q3 2020, revenue from Lessor Interests on Fee Lands was \$24.9 million or 65% of total royalty production revenue. Revenue from GORR Interests was \$13.5 million or 35% of total royalty production

revenue for the same period. In the comparative period, \$34.6 million or 67% of royalty production revenue was generated from Lessor Interests on Fee Lands and \$17.3 million or 33% from GORR Interests. In addition to royalty revenue from Lessor Interests, all lease rental income and bonus consideration are generated from Fee Lands.

The Company's average royalty rate for wells on production in YTD 2020 and YTD 2019 was approximately 6.0%. During YTD 2020, royalty production revenue was \$112.6 million, a 38% decrease compared to \$181.5 million for the same period in 2019. The decrease in royalty production revenue was primarily due to the 33% decrease in WTI benchmark oil pricing, wider Canadian differentials for light and heavy oil, and lower oil royalty production volumes due to shut in production.

During YTD 2020, revenue from the Lessor Interests was \$70.5 million or 63% of total royalty production revenue. Revenue from GORR Interests was \$42.1 million or 37% of total royalty production revenue for the same period. In the comparative period, \$120.1 million or 66% and \$61.4 million or 34% of royalty production revenue was generated from Lessor Interests and GORR Interests, respectively. The increase in revenue generated from GORR Interests as a percentage of total royalty production revenue is reflective of the impact of revenues from GORR Interests acquired over multiple years, and increased activity on GORR Lands.

During Q3 2020, the Company averaged realized crude oil pricing of \$41.11 per bbl, NGL pricing of \$21.43 per bbl and natural gas pricing of \$1.62 per Mcf. The realized pricing on crude oil decreased from Q3 2019 when the Company averaged realized crude oil pricing of \$59.04 per bbl. Realized pricing for crude oil was negatively impacted by a 28% decrease in benchmark WTI pricing as a result of global supply and demand disruptions. This decrease was partially offset by narrower Canadian light and heavy oil differentials. Realized NGL pricing in Q3 2020 was relatively flat at \$21.43 per bbl as compared to \$20.23 for Q3 2019 as lower benchmark pricing was offset by improved propane and butane differentials under the new NGL contract year. Realized natural gas pricing increased to \$1.62 per Mcf in Q3 2020 from \$0.72 per Mcf in Q3 2019. AECO benchmark pricing increased in Q3 2020 due to changes in the NGTL system Temporary Service Protocol which positively impacted realized natural gas pricing.

YTD 2020, the Company averaged realized crude oil pricing of \$36.82 per bbl, and NGL pricing of \$21.92 per bbl. Realized pricing for liquids production decreased compared to YTD 2019 when the Company averaged realized crude oil pricing of \$60.79 per bbl and NGL pricing of \$28.81 per bbl due to a 33% decline in the benchmark WTI price. Realized crude oil pricing was further impacted by wider average differentials for Canadian light and heavy oil. NGL realized pricing, as a percentage of benchmark pricing, was positively impacted by improved propane and butane differentials under the new NGL contract year. Higher average AECO benchmark pricing, primarily due to changes to the NGTL system Temporary Service Protocol, resulted in improved realized natural gas pricing for YTD 2020 of \$1.52 per Mcf, a 33% increase from \$1.14 per Mcf in YTD 2019.

Royalty compliance recoveries are the cash payments received as a result of the extensive process of identifying, analyzing, resolving and collecting corrected payments from royalty payors. Cash received from compliance recoveries can cover a number of periods. PrairieSky's compliance department continually reviews leasing agreements and royalty calculations. Compliance adjustments are not recorded in the financial statements until collection is certain. For Q3 2020 and YTD 2020, the Company collected \$1.0 million (Q3 2019 - \$1.8 million) and \$5.0 million (YTD 2019 - \$5.6 million), respectively, in compliance recoveries. Compliance recoveries are included in royalty production revenue for the period.

Other revenue consisted primarily of lease rental income and lease bonus consideration from new leasing arrangements as well as leases currently issued in respect of certain Fee Lands. Lease rental income for Q3 2020 and YTD 2020 was \$1.2 million (Q3 2019 - \$1.2 million) and \$4.1 million (YTD 2019 - \$5.0 million), respectively. Bonus consideration revenue for Q3 2020 and YTD 2020 was \$1.8 million (Q3 2019 - \$4.4 million) and \$4.9 million (YTD 2019 - \$10.7 million), respectively. Both the amount and timing of bonus consideration revenue can vary significantly from quarter to quarter as it relates to the unique circumstances of each transaction. Other income was \$2.1 million for Q3 2020 (Q3 2019 - \$1.3 million) and \$2.8 million for YTD 2020 (YTD 2019 - \$4.1 million) and primarily related to the collection of non-performance fees.

## ADMINISTRATIVE EXPENSES

(\$ millions)	Three months ended September 30		Nine months ended September 30	
	2020	2019	2020	2019
Salaries and Benefits	\$ 2.3	\$ 3.3	\$ 8.2	\$ 9.9
Share-Based Compensation	0.6	2.0	0.9	5.6
Office Expense	0.5	0.6	1.8	2.0
Public Company Expense	0.3	0.2	1.3	1.3
Information Technology and Other	0.4	0.6	1.5	1.8
Total Administrative Expenses	\$ 4.1	\$ 6.7	\$ 13.7	\$ 20.6
Administrative Expenses per BOE <sup>(1)</sup>	\$ 2.38	\$ 3.55	\$ 2.52	\$ 3.49
Cash Administrative Expenses <sup>(2)</sup>	\$ 3.5	\$ 4.7	\$ 14.5	\$ 17.2
Cash Administrative Expenses per BOE <sup>(1)(2)</sup>	\$ 2.03	\$ 2.49	\$ 2.67	\$ 2.92

(1) See "Conversions of Natural Gas to BOE".

(2) Non-GAAP measure. See "Non-GAAP Measures" in the MD&A.

PrairieSky is committed to cost control, finding efficiencies, and optimizing technology across the business. Administrative expenses for Q3 2020 and YTD 2020 were \$2.38 per BOE (Q3 2019 - \$3.55 per BOE) and \$2.52 per BOE (YTD 2019 - \$3.49 per BOE), respectively. Administrative expenses include both cash and non-cash charges which relate to share-based compensation plans. Administrative expenses related to restricted share units ("RSUs"), preferred share units ("PSUs"), officer deferred share units ("ODSUs"), and deferred share units ("DSUs") are impacted by the closing share price at period end and as such, are subject to variability.

Cash administrative expenses of \$3.5 million (\$2.03 per BOE) for Q3 2020 were down 26% from Q3 2019 cash administrative expenses of \$4.7 million (\$2.49 per BOE) primarily as a result of receipt of the Canadian Emergency Wage Subsidy which was put in place to support businesses as a result of COVID-19. Cash administrative expenses for YTD 2020 were \$14.5 million (\$2.67 per BOE), a 16% decrease from YTD 2019 cash administrative expenses of \$17.2 million (\$2.92 per BOE) primarily as a result of the effect of a decreased share price on the settlement of share-based compensation plans that occurs in the first quarter of each year and receipt of the wage subsidy as discussed above.

Company payouts related to share-based compensation for the entire organization, including executives, during Q3 2020 were \$nil (Q3 2019 - \$nil) and \$1.7 million during YTD 2020 (YTD 2019 - \$2.2 million). When cash share-based payments are made, there is an increase in cash administrative expenses in the period. Cash payments decreased in YTD 2020 as compared to YTD 2019 due to lower pricing used in the calculation of the payout under the RSU and PSU plans in the current year, as well as a lower performance factor related to the PSUs.

(\$ millions)	Three months ended September 30		Nine months ended September 30	
	2020	2019	2020	2019
Share-Based Compensation				
Stock Option Expense	\$ 0.2	\$ 0.4	\$ 0.8	\$ 1.4
PSU Expense	0.4	1.3	0.4	2.2
RSU Expense	0.1	0.3	0.2	0.9
ODSU Expense	-	-	0.1	-
DSU Expense (Recovery)	(0.1)	-	(0.6)	1.1
Total Share-Based Compensation Expense	\$ 0.6	\$ 2.0	\$ 0.9	\$ 5.6

Share-based compensation expense is impacted by the closing share price at period end. The expense recorded in Q3 2020 was lower than in Q3 2019 due to changes in the share price and fluctuations in the performance factor related to PSUs.

Share-based compensation expense for YTD 2020 is lower than YTD 2019 as the decrease in the share price from December 31, 2019 to September 30, 2020 resulted in a recovery of a portion of expense previously incurred, which partially offset the expense related to new grants. Total outstanding units and

options from all employee, officer, and director incentive plans is 1.0% of total common shares outstanding at September 30, 2020.

## PRODUCTION AND MINERAL TAXES

(\$ millions, except per BOE amounts)	Three months ended September 30		Nine months ended September 30	
	2020	2019	2020	2019
Production and Mineral Taxes	\$ 0.6	\$ 1.2	\$ 1.6	\$ 3.3
\$/BOE <sup>(1)</sup>	\$ 0.35	\$ 0.64	\$ 0.29	\$ 0.56

(1) See "Conversions of Natural Gas to BOE".

Production and mineral taxes are levied on an annual basis on the value of crude oil and natural gas production or the amount of acreage from non-Crown lands. For Q3 2020, production and mineral taxes, which includes Alberta Freehold Mineral Tax and Saskatchewan acreage tax, was 1.6% of royalty production revenue compared to 2.3% for Q3 2019. YTD 2020, production and mineral taxes totaled 1.4% of royalty production revenue compared to 1.8% in YTD 2019. Saskatchewan acreage tax does not vary with commodity pricing while Alberta Freehold Mineral Tax is impacted by both production and commodity pricing. Production and mineral taxes are based on an annual estimate which can result in variances from quarter to quarter.

## DEPLETION, DEPRECIATION AND AMORTIZATION ("DD&A")

(\$ millions, except per BOE amounts)	Three months ended September 30		Nine months ended September 30	
	2020	2019	2020	2019
Depletion, Depreciation and Amortization	\$ 25.9	\$ 29.2	\$ 81.3	\$ 92.4
\$/BOE <sup>(1)</sup>	\$ 15.02	\$ 15.47	\$ 14.95	\$ 15.67

(1) See "Conversions of Natural Gas to BOE".

The Company depletes its royalty assets using the unit-of-production method based on the total proved and probable reserves of its Royalty Properties. Corporate assets, including the right-of-use asset associated with the office lease, are depreciated on a straight-line basis. DD&A per BOE was lower in Q3 2020 and YTD 2020 than the prior year comparative periods due to a lower depletable base and lower production volumes. DD&A per BOE will fluctuate depending on the royalty assets acquired, if any, the amount of reserves added, and production volumes in the period.

## EXPLORATION AND EVALUATION EXPENSE ("E&E")

(\$ millions, except per BOE amounts)	Three months ended September 30		Nine months ended September 30	
	2020	2019	2020	2019
Exploration and Evaluation Expense	\$ 0.6	\$ 1.4	\$ 4.9	\$ 4.7
\$/BOE <sup>(1)</sup>	\$ 0.35	\$ 0.74	\$ 0.90	\$ 0.80

(1) See "Conversions of Natural Gas to BOE".

During Q3 2020 and YTD 2020, \$0.6 million (Q3 2019 - \$1.4 million) and \$4.9 million (YTD 2019 - \$4.7 million), respectively, of costs associated with expired Crown mineral leases and gross overriding royalties were recognized as an expense. The expense will vary period to period as a result of the timing of lease expiries, if any.

## FINANCE

Finance expense of \$0.4 million in Q3 2020 has increased from \$0.3 million in Q3 2019, as the increased bank debt balance offset the reduction in corporate interest rates. YTD 2020, \$1.0 million in finance expense decreased from \$1.2 million reported during YTD 2019, as a result of the decrease in corporate interest rates during 2020.

## INCOME TAX

(\$ millions)	Three months ended September 30		Nine months ended September 30	
	2020	2019	2020	2019
Current Tax Expense	\$ 1.1	\$ 2.6	\$ 1.7	\$ 13.9
Deferred Tax Expense (Recovery)	1.4	0.7	2.6	(21.9)
Income Tax Expense (Recovery)	\$ 2.5	\$ 3.3	\$ 4.3	\$ (8.0)

The Company's interim income tax expense is determined using the estimated annual effective income tax rate applied to year-to-date net earnings before tax. The Company's effective tax rate differs from PrairieSky's combined Provincial and Federal statutory tax rate of 25.3% primarily as a result of the reversal of the initial difference between the carrying value of net assets transferred and the tax pools acquired on May 27, 2014, for which no deferred tax asset was recognized, partially offset by non-deductible employee-related expenses. In addition, the Company has incorporated the enacted Alberta corporate income tax rate reduction to 10% on January 1, 2020 with reductions of 1% effective for each year commencing January 1, 2021 and 2022 bringing the rate to 8%. The Alberta Provincial government has tabled legislation to accelerate the provincial rate change to 8% effective July 1, 2020. This legislation became substantively enacted on October 20, 2020.

## NET EARNINGS

Net earnings for Q3 2020 was \$9.4 million (\$0.04 per share basic and diluted) and net earnings for YTD 2020 was \$17.6 million (\$0.08 per share, basic and diluted). Net earnings in the prior year were \$16.7 million for Q3 2019 (\$0.07 per share, basic and diluted) and \$87.1 million for YTD 2019 (\$0.37 per share, basic and diluted). Net earnings for both periods in 2020 were lower than in 2019 primarily as a result of the decrease in royalty revenues as previously noted, which were partially offset by lower administration and DD&A expenses. YTD 2019 also benefited from a deferred income tax recovery due to the reduction in Provincial income tax rates as noted above.

## ACQUISITIONS

During Q3 2020, the Company completed no acquisitions. In the comparable prior year periods, \$5.2 million was spent on E&E assets consisting of royalty interests on producing and non-producing properties, fee simple land, undeveloped Crown land and seismic.

YTD 2020, the Company completed acquisitions totaling \$6.7 million (YTD 2019 - \$7.8 million) comprised of royalty assets of \$4.7 million (YTD 2019 - \$0.1 million) and E&E assets of \$2.0 million (YTD 2019 - \$7.7 million).

## LIQUIDITY AND CAPITAL RESOURCES

(\$ millions)	Three months ended September 30		Nine months ended September 30	
	2020	2019	2020	2019
Net Cash From (Used In)				
Operating Activities	\$ 33.8	\$ 55.0	\$ 112.8	\$ 157.7
Investing Activities	-	(1.5)	(6.7)	(4.1)
Financing Activities	(33.8)	(53.5)	(106.1)	(153.6)
<b>Change in Cash and Cash Equivalents</b>	\$ -	\$ -	\$ -	\$ -
<b>Cash and Cash Equivalents, Beginning of Period</b>	\$ -	\$ -	\$ -	\$ -
<b>Cash and Cash Equivalents, End of Period</b>	\$ -	\$ -	\$ -	\$ -

## **OPERATING ACTIVITIES**

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Net cash from operating activities for Q3 2020 and YTD 2020 was \$33.8 million and \$112.8 million, respectively, as compared to \$55.0 million and \$157.7 million for the comparable periods in 2019. Net cash from operating activities is generated from funds from operations and the net change in non-cash working capital. Funds from operations is utilized by management to evaluate the ability of the Company to generate cash from its operations. This is considered a measure of operating performance as it demonstrates the Company's ability, on an ongoing basis, to fund distributions of cash flow to shareholders as dividends, to repurchase common shares under the Company's NCIB, as well as fund complementary acquisitions. Such a measure provides a useful indicator of the Company's operations, on an ongoing basis, by eliminating certain non-cash charges. Funds from operations in Q3 2020 and YTD 2020 were \$37.9 million and \$105.7 million, respectively, a decrease of 22% from \$48.8 million in Q3 2019 and a decrease of 36% from \$164.6 million in YTD 2019 primarily due to a decline in WTI benchmark pricing combined with lower oil production volumes due to shut-in production. This was partially offset by increased natural gas royalty revenue due to stronger AECO benchmark pricing.

## **INVESTING ACTIVITIES**

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There were no acquisitions during Q3 2020. For YTD 2020, cash used in investing activities was \$6.7 million related to royalty and E&E asset acquisitions as outlined in the "Acquisitions" section of this MD&A. During Q3 2019 and YTD 2019, cash flows used in investing activities were \$1.5 million and \$4.1 million, respectively.

## **FINANCING ACTIVITIES**

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For Q3 2020 and YTD 2020, cash used in financing activities was \$33.8 million (Q3 2019 - \$53.5 million) and \$106.1 million (YTD 2019 - \$153.6 million), respectively. Dividends paid in Q3 2020 were \$13.9 million (Q3 2019 - \$45.5 million) and \$74.4 million for YTD 2020 (YTD 2019 - \$136.7 million). In addition, the Company repurchased \$81.8 million in common shares under the NCIB in Q3 2020 (Q3 2019 - \$4.2 million) and \$90.9 million in YTD 2020 (YTD 2019 - \$16.2 million) as described below. The share repurchases were funded with funds from operations in excess of the quarterly dividend, and by drawing down on the Company's available credit facility.

Since the initial public offering in May 2014 (the "IPO"), PrairieSky has declared \$1,104.7 million in dividends to shareholders. Since inception of the NCIB in 2016, PrairieSky has purchased for cancellation 15.0 million common shares at an average cost of \$14.90 per share for total consideration of \$223.7 million.

## **Changes in Working Capital**

The Company had a working capital deficiency of \$66.2 million at September 30, 2020. The working capital deficiency has increased from \$3.1 million at December 31, 2019 as the Company increased purchases under its NCIB by acquiring and cancelling \$90.9 million in common shares during YTD 2020. The working capital deficiency includes \$2.1 million (December 31, 2019 - \$2.7 million) related to the liability for vested cash-settled DSUs for Board members which may or may not be paid in the next twelve months as amounts only become payable when a director is no longer a member of the Board. At September 30, 2020, accounts receivable and accrued revenue consisted primarily of accrued revenue related to royalty payments. In the crude oil and natural gas industry, accounts receivable from industry partners are typically settled in the following month; however, payments to royalty owners are often delayed longer, and as a result, actual payments may differ from estimates recorded. Accounts payable and accrued liabilities consisted primarily of share-based compensation and salary-related accruals. At September 30, 2020 income taxes payable totaled \$0.5 million (December 31, 2019 - \$4.7 million).

## **Bank Debt**

On May 15, 2018, the Company entered into a \$200 million extendible revolving credit facility (the "Revolving Facility"), with a permitted increase to \$250 million, subject to lender consent, and renewed the \$25 million extendible operating credit facility (the "Operating Facility", and together with the Revolving Facility, the "Credit Facility"), with a syndicate of Canadian banks.

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, may be extendible annually. Management intends to renew the Credit Facility prior to the May 15, 2021 maturity. The credit facility has three financial covenants, whereby the Company's ratio of adjusted consolidated senior debt to EBITDA for the 12 trailing months will not exceed 3.5:1.0, adjusted consolidated total debt to EBITDA for the 12 trailing months 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. All covenants are calculated as at and for the 12 months ending September 30, 2020. As at September 30, 2020, the Company was compliant with all covenants provided for in the lending agreement.

The following table provides a listing of the key financial covenants as at September 30, 2020:

Covenant Description <sup>(1)</sup>	Ratio	September 30 2020
Adjusted Consolidated Senior Debt to EBITDA	Maximum 3.5:1	0.4
Adjusted Consolidated Total Debt to EBITDA	Maximum 4.0:1	0.4
Adjusted Consolidated Total Debt to Capitalization	Maximum 55%	2.9%

(1) Capitalized terms are as defined in the Credit Facility agreement.

The covenants noted above are subject to specific definitions in the Credit Facility agreement.

As at September 30, 2020, the Company had \$67.0 million in bank debt outstanding on the Credit Facility (December 31, 2019 - \$7.3 million). The increase in bank debt was due to the share repurchases under the NCIB which is further discussed below. The effective interest rate for Q3 2020 was 2.1% and for YTD 2020 was 2.8% (Q3 2019 and YTD 2019 - 4.5%).

## Dividends and Dividend Policy

PrairieSky currently pays a quarterly dividend to shareholders at the discretion of the Board. Dividends declared were \$13.4 million or \$0.06 per share for Q3 2020 and \$72.7 million or \$0.3150 per share for YTD 2020. The YTD 2020 dividends of \$72.4 million include mainly dividends of \$0.065 per share declared for the first three months of 2020 which totaled \$45.4 million.

Due to the unprecedented global market volatility, on March 16, 2020, the Company announced the move to a quarterly dividend which commenced in Q2 2020 with the first quarterly dividend paid to holders of record on July 15, 2020. The dividend was adjusted to \$0.24 per common share annually (\$0.06 per common share quarterly) for the balance of 2020.

The Board of Directors determines the dividend rate after considering expected commodity prices, foreign exchange rates, production volumes, economic conditions, income taxes, and PrairieSky's capacity to fund operating expenses and investing opportunities. The dividend rate is established with the intent of absorbing short-term market volatility, including commodity price volatility, over several months. It also recognizes the intention of maintaining a strong financial position to take advantage of business opportunities, including share repurchases and cancellations under the NCIB and acquisitions.

## Outstanding Share Data

As at September 30, 2020, PrairieSky had 223.3 million common shares outstanding (December 31, 2019 - 233.1 million) and 1.6 million outstanding stock options (December 31, 2019 - 1.6 million) which have a weighted average exercise price of \$22.70, well in excess of the current share price. Total outstanding units and options from all employee, officer, and director incentive plans is 1.0% of total common shares outstanding at September 30, 2020. As at October 26, 2020, there were 223.3 million common shares outstanding.

## 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 to repurchase shares for cancellation after consideration of the Company's financial requirements for its business and future growth opportunities. As a royalty company, PrairieSky does not incur capital expenditures for crude oil and natural gas development, which differentiates its cost structure from producers and 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, income taxes, available Credit Facility and other factors. The Company's operating results and capital structure are impacted by the level of leasing and development activity by third parties on the Royalty Properties, commodity prices and the resultant royalty production revenues, as well as the costs incurred by the Company.

Stewardship of the Company's capital structure is managed through its financial and operating forecast process. The Company's forecast of future cash flows is based on estimates of production, crude oil, natural gas and NGL prices, production and mineral tax expense, administrative expenses, income taxes 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, would impact future cash flows. However, in light of the current volatility in commodity prices and uncertainty regarding the timing for recovery in such prices, along with the effect of COVID-19 on global crude oil demand, the preparation of financial forecasts is challenging. As a result, there may be adverse changes in cash flows, working capital or debt levels that are currently unforeseen.

On May 13, 2020 the Company announced the approval of the renewal of its NCIB by the Toronto Stock Exchange ("TSX"). The NCIB allows the Company to purchase for cancellation up to a maximum of 11,600,000 common shares over a twelve-month period which commenced on May 19, 2020 and expires no later than May 18, 2021. The actual number of common shares that may be purchased will be determined by the Company based on current and forecast funds from operations. Purchases are made on the open market through the TSX or alternative platforms at the market price of such common shares. All common shares purchased under the NCIB are cancelled.

During Q3 2020, the Company purchased for cancellation 8,866,991 common shares (Q3 2019 - 241,600 common shares) at a weighted average price of \$9.22 per common share (Q3 2019 - \$17.54 per common share), including commissions, for total consideration of \$81.8 million (Q3 2019 - \$4.2 million). The total cost paid, including commissions and fees, was charged to share capital as there was no excess paid over the average carrying value of the common shares purchased and thus \$nil (Q3 2019 - \$0.8 million) was charged to the deficit.

During YTD 2020, the Company purchased for cancellation 9,770,691 common shares (YTD 2019 - 883,920 common shares) at a weighted average price of \$9.30 per common share (YTD 2019 - \$18.38 per common share), including commissions, for total consideration of \$90.9 million (YTD 2019 - \$16.2 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 \$0.2 million (YTD 2019 - \$3.7 million) was charged to the deficit.

## RISK MANAGEMENT

### FINANCIAL RISKS

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The Company is exposed to financial risks arising from its financial assets and liabilities. Financial risks include market risk (commodity prices and interest rates), 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. As a result of the COVID-19 global health crisis, crude oil demand dropped sharply and at the same time global participants increased supply which negatively impacted global oil prices. Although health restrictions have eased and certain global oil participants are producing in compliance with supply agreements, the Company remains subject to increased commodity price risk. The Company does not hedge its commodity price risk.

#### Interest Rate Risk

The Company is exposed to interest rate risk on its credit facility. 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. The Company's diversified revenue stream limits the size of any one property or industry operator with respect to total receivables. During these unprecedented market challenges as a result of COVID-19, and the resulting decrease in global crude oil demand, collection of accounts receivable from third-party lessees remains a priority for the Company.

The Company maintains a compliance program to ensure royalties are paid correctly on production from the Royalty Properties in accordance with the terms of the agreements. This includes reviewing and analyzing prices obtained by the royalty payor and ensuring that unwarranted or excessive deductions are not being taken.

A substantial portion of the Company's accounts receivable are from leases, overriding royalty contracts and other agreements with crude oil and natural gas industry operators and are subject to normal industry credit risks. The Company's leasing arrangements typically provide for termination of the lease in the event of non-payment of royalties which would result in a return of the petroleum and natural gas rights to the Company. In addition, the Company actively reviews its counterparties and takes its production in-kind to mitigate credit risk, as appropriate, and has letters of credit in place with certain producers.

As at September 30, 2020, there were no counterparties 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.

#### Liquidity Risk

Liquidity risk is the risk that the Company will encounter difficulties funding its financial liabilities as they come due. Liquidity risk is managed by maintaining sufficient liquid financial resources to fund these obligations. At September 30, 2020, the Company had a working capital deficiency of \$66.2 million, an increase from \$3.1 million at December 31, 2019. This increase is primarily a result of an increased number of repurchased and cancelled common shares under the NCIB during YTD 2020. The Company also has access to funding alternatives through its \$225 million Credit Facility. In light of the current volatility in commodity prices and uncertainty regarding the timing for recovery in such prices, along with the effect of COVID-19 on global

crude oil demand, the preparation of financial forecasts is challenging. As a result, there may be adverse changes in cash flows, working capital or debt levels that are currently unforeseen.

The Company's royalty production volumes and resultant revenues with high operating netbacks provide significant liquidity. The primary uses of funds are acquisitions, administrative expenses, production and mineral taxes, income taxes, dividends, and the repurchase and cancellation of PrairieSky common shares. The Company's dividend, common share repurchases and capital acquisitions are discretionary. The Company has unused capacity under its Credit Facility of up to \$158.0 million.

The timing of expected cash outflows relating to bank debt of \$67.0 million, accounts payable and accrued liabilities of \$11.2 million, income taxes payable of \$0.5 million, and the dividend payable of \$13.4 million is less than one year. Management intends to renew the Credit Facility prior to the May 15, 2021 maturity. Included in accounts payable and accrued liabilities is \$2.1 million related to vested cash-settled DSUs held by Board members which may or may not be paid in the next year as the amount only becomes payable when a director is no longer a member of the Board.

## **OPERATIONAL AND BUSINESS RISKS**

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PrairieSky has identified key operational and business risks that may impact financial results. The most significant of these risks are as follows:

- Volatility in commodity prices and quality differentials as a result of global and North American market forces and/or shifts in the balance between supply and demand for crude oil, NGL, and natural gas, including the impacts of COVID-19 on crude oil demand;
- Access to transportation, including pipelines or other methods, for bringing crude oil and natural gas to market;
- Dependence on lessees and/or third-party operators to develop the Royalty Properties and the risks associated with exploration, development and production of crude oil and natural gas, including environmental risks and climate change, as further discussed below;
- Ability of participants in the crude oil and natural gas industry in Western Canada to access capital to develop the Royalty Properties and the industry as a whole;
- Third-party operator activity levels on the Royalty Properties and competition for land, goods and services, qualified personnel and capital funding;
- Variations in currency exchange rates;
- Imprecision of reserve estimates and uncertainty of depletion and recoverability of reserves. The Company's reserves will deplete over time through continued production and our industry partners and royalty payors may not be able to replace the reserves on the Royalty Properties on an economic basis;
- Stock market volatility and the ability to access sufficient capital from internal and external sources;
- Third-party operational risks, including facility restrictions and weather, or marketing risks, including take-in-kind production volumes, resulting in delivery interruptions, delays, lower realized pricing and/or unanticipated production declines;
- Changes in government regulations, including mandated production curtailments, taxation, environmental and Crown royalty rates;
- Potential breakdown, invasion, virus, cyber-attack, security breach or destruction of information technology systems; and
- Variability of dividends based on PrairieSky's financial performance and/or market conditions.

The Company employs the following strategies to mitigate these risks:

- Our Royalty Properties are diversified which limits the exposure to any one royalty payor, commodity, area, region or operator;
- We are a royalty interest holder and have no direct exposure to environmental claims and regulation or the associated costs;
- We are focused on controlling direct costs in order to maximize our funds from operations;

- Our royalty interest agreements and contracts provide mechanisms to ensure that our interests are protected;
- Systems and compliance processes are in place to identify and pursue any unpaid or incorrect revenues;
- Measures and processes, which include a recovery plan, are in place to reduce the risk of cyber-attacks to protect our information systems from being breached;
- We maintain a strong capital structure; and
- We maintain levels of liability insurance that meet or exceed industry standards.

## **ENVIRONMENTAL RISKS**

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The Canadian crude oil and natural gas industry is currently subject to environmental regulation under a variety of Canadian federal, provincial, territorial and municipal laws and regulations, all of which are subject to governmental review and revision from time to time. These regulations are some of the most stringent and progressive in the world. Such regulations provide for, among other things, restrictions and prohibitions on the spill, release or emission of various substances produced in association with certain crude oil and natural gas industry operations, including the abandonment and reclamation of well, facility and pipeline sites. Compliance with such regulations can require significant expenditures by the businesses operating on the Royalty Properties and a breach of such requirements may result in suspension or revocation of necessary licences and authorizations, civil liability and the imposition of material fines and penalties. In addition, compliance with such regulations is required for a third-party to keep a lease on the Fee Lands in good standing. Failure to adhere to applicable regulations and contractual requirements can lead to a default and subsequent termination of a Fee Lands lease by PrairieSky. Further to these specific, known requirements, future changes to environmental legislation, including legislation for air pollution and greenhouse gas emissions, may impose further requirements on operators and other companies in the crude oil and natural gas industry. PrairieSky works with applicable federal, provincial and municipal regulators to ensure compliance.

Third-party operations and activities associated with the Royalty Properties emit greenhouse gases which may require parties leasing and/or operating the Royalty Properties to comply with federal and/or provincial greenhouse gas emissions legislation. Climate change policy is evolving at regional, national and international levels, and political and economic events may significantly affect the scope and timing of climate measures that are ultimately put in place. Lessees and third-party operators of the Royalty Properties are responsible for the costs associated with environmental regulation and adherence to regulation. PrairieSky may be directly impacted by reduced industry activity or the inability to collect royalty payments. Given the evolving nature of the debate related to climate change and the control of greenhouse gases and resulting requirements, it is not possible to predict the impact of those requirements on the Company's operations and financial condition. Additional specific risk factors related to the environment and climate change are included in PrairieSky's Annual Information Form and readers are encouraged to review such material, as well as PrairieSky's Responsibility Report which is located on our website at [www.prairiesky.com](http://www.prairiesky.com).

## **FURTHER INFORMATION ON RISK FACTORS AND INDUSTRY CONDITIONS**

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For a detailed discussion of the risks, uncertainties and industry conditions associated with PrairieSky's business, refer to PrairieSky's Annual Information Form dated February 10, 2020, which is available under PrairieSky's SEDAR profile at [www.sedar.com](http://www.sedar.com) and at [www.prairiesky.com](http://www.prairiesky.com).

## **ACCOUNTING JUDGMENTS, ESTIMATES AND ACCOUNTING POLICIES**

### **ACCOUNTING JUDGMENTS AND ESTIMATES**

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Certain of the Company's accounting policies require subjective judgment about uncertain circumstances. The potential effect of these estimates, as described in the Company's 2019 Annual MD&A, have not changed during the current period, except as noted below under "Accounting Policy Changes" and as noted in the interim condensed consolidated financial statements for the three and nine months ended September 30, 2020. The emergence of new information and changed circumstances may result in actual results or changes to estimated amounts that differ materially from current estimates.

## ACCOUNTING POLICY CHANGES

### IFRS 3

On January 1, 2020, the Company adopted the amendments to the definition of a business in IFRS 3 Business Combinations. The amendments are intended to assist entities to determine whether a transaction should be accounted for as a business combination or as an asset acquisition. IFRS 3 continues to adopt a market participant's perspective to determine whether an acquired set of activities and assets is a business. The amendments clarify the minimum requirements for a business; remove the assessment of whether market participants are capable of replacing any missing elements; add guidance to help entities assess whether an acquired process is substantive; narrow the definitions of a business and of outputs; and introduce an optional fair value concentration test. No business combinations were completed during the nine months ended September 30, 2020.

## CONTROL ENVIRONMENT

PrairieSky is required to comply with National Instrument 52-109 "Certification of Disclosure on Issuers' Annual and Interim Filings". The certification of interim filings for the interim period ended September 30, 2020 requires that PrairieSky disclose in the interim MD&A any changes in PrairieSky's internal controls over financial reporting that occurred during the period that have materially affected, or are reasonably likely to materially affect PrairieSky's internal controls over financial reporting. PrairieSky confirms that no such changes were identified in the Company's internal controls over financial reporting during the three months beginning on July 1, 2020 and ending on September 30, 2020.

## SUMMARY OF QUARTERLY RESULTS AND TRENDS

(\$ millions, unless otherwise noted)	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020
<b>FINANCIAL</b>								
Royalty Production Revenue	\$ 42.4	\$ 66.5	\$ 63.1	\$ 51.9	\$ 63.4	\$ 49.1	\$ 25.1	\$ 38.4
Other Revenue	9.2	6.7	6.2	6.9	3.7	3.6	3.1	5.1
Total Revenue	51.6	73.2	69.3	58.8	67.1	52.7	28.2	43.5
Funds from Operations	48.5	57.8	58.0	48.8	55.8	46.5	21.3	37.9
Per Share - basic <sup>(1)</sup>	0.21	0.25	0.25	0.21	0.24	0.20	0.09	0.16
Per Share - diluted <sup>(1)</sup>	0.21	0.25	0.24	0.21	0.24	0.20	0.09	0.16
Net Earnings (Loss)	6.0	26.4	44.0	16.7	24.3	8.6	(0.4)	9.4
Per Share - basic and diluted <sup>(1)</sup>	0.03	0.11	0.19	0.07	0.10	0.04	(0.00)	0.04
Dividends Declared <sup>(2)</sup>	45.7	45.6	45.6	45.5	45.4	45.4	13.9	13.4
Per Share	0.1950	0.1950	0.1950	0.1950	0.1950	0.1950	0.0600	0.0600
Working Capital (Deficiency)	(10.4)	(6.2)	(2.1)	(7.4)	(3.1)	(5.2)	(8.7)	(66.2)
<b>OPERATIONAL</b>								
<b>Production Volumes</b>								
Crude Oil (bbls/d)	9,163	8,904	8,740	8,011	8,884	8,582	6,035	6,572
NGL (bbls/d)	2,676	2,586	2,690	2,334	2,819	2,945	2,586	2,473
Natural Gas (MMcf/d)	70.0	63.1	65.2	61.0	63.0	63.8	60.3	58.2
Total (BOE/d) <sup>(3)</sup>	23,506	22,007	22,297	20,512	22,203	22,160	18,671	18,745

(1) Net Earnings and Funds from Operations per Share are calculated using the weighted average number of basic and diluted common shares outstanding.

(2) A dividend of \$0.06 per common share was declared on September 9, 2020. The dividend was paid on October 15, 2020 to shareholders of record on September 30, 2020.

(3) See "Conversions of Natural Gas to BOE".

- Quarterly variances in revenues, funds from operations and net earnings are primarily due to fluctuations in realized commodity prices, royalty production volumes, and bonus consideration.

- Crude oil prices are generally determined by global and North American market forces, including supply and demand factors. Changes in the USD-CAD currency exchange rate impact the Company's oil price realization relative to benchmark WTI, which is referenced in US dollars. In the fourth quarter of 2018, realized commodity prices were negatively impacted by wider differentials for Canadian light and heavy crude oil to WTI due to constrained transportation capacity. Differentials narrowed in 2019 with the Alberta government's oil production curtailments but increased again in Q1 2020 due to global crude oil demand and supply imbalances primarily as a result of COVID-19. Differentials narrowed in Q2 2020 and Q3 2020 but did not offset the significant decline in WTI benchmark pricing.
- Natural gas prices are influenced by many variables including weather conditions, industrial demand, and North American natural gas inventories. In Western Canada, transportation constraints further impact natural gas prices.
- Royalty production volumes can be influenced by various factors, including the extent of exploration and development activity by third parties on the Royalty Properties, the timing and amount of capital expenditures, the expertise and financial resources of third-party lessees, acquisitions of producing properties and natural declines.
- Other revenue is largely affected by the timing of bonus consideration received when new leases are negotiated, which can vary with the individual terms of each agreement.
- Net earnings are affected by revenues, as noted above, as well as depletion, administrative expenses and income taxes. Administrative expenses can vary in a period due to the effect of the change in share price on the Company's share-based compensation plans. The Alberta corporate income tax rate was reduced for the periods from July 1, 2019 to 2022, bringing the provincial income tax rate from 12% to 11% effective July 1, 2019 and further reducing the rate by 1% effective January 1, 2020 with additional 1% reductions commencing January 1, 2021, and 2022. The initial deferred tax recovery related to the tax rate reductions was recorded in Q2 2019.
- Dividends decline marginally as the number of shares outstanding in the quarter is reduced by share repurchases and cancellations under the NCIB. The dividend is set by the Board of Directors by considering forecasted funds from operations for the next year. Due to global market volatility, the dividend was adjusted to a quarterly dividend commencing in Q2 2020 of \$0.06 per common share.
- The Company has declared \$300.5 million in dividends to shareholders and has repurchased over 11.3 million common shares for \$119.7 million over the past eight quarters.
- The working capital deficiency increased in Q3 2020 as a result of the significant increase in the number of shares repurchased and cancelled under the NCIB. In prior quarters, the working capital deficiency fluctuated primarily as a result of changes in commodity prices affecting the royalty production revenue receivable recorded.

## NON-GAAP MEASURES

Certain measures in this MD&A do not have any standardized meaning as prescribed by IFRS and therefore, are considered non-GAAP measures. These measures may not be comparable to similar measures presented by other issuers. These measures are commonly used in the crude oil and natural gas industry and by the Company to provide potential investors with additional information regarding the Company's liquidity and its ability to generate funds to finance its operations. Non-GAAP measures include operating netback, operating netback per BOE, cash administrative expenses and cash administrative expenses per BOE. Management's use of these measures is discussed further below.

"Operating Netback" represents the cash margin for products sold. Operating netback is calculated as royalty revenue less production and mineral taxes and administrative expenses. Operating netback provides a

consistent measure of the cash generating and operating performance of the Royalty Properties to assess the comparability of the underlying performance between years.

"Operating Netback per BOE" represents the cash margin for products sold on a BOE basis. Operating netback per BOE is calculated by dividing the operating netback by the average daily production volumes for the period. Operating netback per BOE is used to assess the cash generating and operating performance per unit of product sold. Operating netback per BOE measures are commonly used in the crude oil and natural gas industry to assess performance comparability. Refer to the Operating Results table in this MD&A document for a summary of this reporting period's operating netback calculations.

"Cash Administrative Expenses" represents administrative expenses excluding the volatility and fluctuations in share-based compensation expense for RSUs, PSUs, ODSUs and DSUs and stock options that were not settled in cash in the current period. Cash administrative expenses are calculated as total administrative expenses, adjusting for share-based compensation expense (recovery) in the period, plus any actual cash payments made under the RSU, PSU, ODSU or DSU plans. Management believes cash administrative expenses are a common benchmark used by investors when comparing companies to evaluate operating performance.

"Cash Administrative Expenses per BOE" represents cash administrative expenses on a BOE basis. Cash administrative expenses per BOE is calculated by dividing cash administrative expenses by the average daily production volumes for the period. Cash administrative expenses per BOE assists management and investors in evaluating operating performance on a comparable basis.

## CASH ADMINISTRATIVE EXPENSES

The following table presents the computation of Cash Administrative Expenses:

(\$ millions)	Three months ended September 30		Nine months ended September 30	
	2020	2019	2020	2019
Total Administrative Expenses	\$ 4.1	\$ 6.7	\$ 13.7	\$ 20.6
Share-Based Compensation Expense	(0.6)	(2.0)	(0.9)	(5.6)
Cash Payments Made Under RSU and PSU Plans	-	-	1.7	2.2
Cash Administrative Expenses	\$ 3.5	\$ 4.7	\$ 14.5	\$ 17.2

## ADVISORY

### FORWARD-LOOKING STATEMENTS

This MD&A includes certain statements regarding PrairieSky's future plans and operations as at October 26, 2020 and contains forward-looking statements that we believe allow readers to better understand our business and prospects. Forward-looking statements contained in this MD&A include our expectations with respect to the following:

- Commodity prices including supply and demand factors relating to crude oil, natural gas and NGL, and specifically the effect of the COVID-19 pandemic on future royalty production volumes, revenues and cash flow;
- Management's intention to renew the Credit Facility prior to maturity in May 2021, and its ability to do so on favorable terms;
- the expected impact of lower NGL and crude oil prices on activity levels in liquids rich natural gas plays;
- expected future commitments and payments related thereto;
- PrairieSky's business and growth strategy and anticipated sources of future income;

- PrairieSky's dividend policy and its intention to distribute the majority of cash flow as dividends and share repurchases and cancellations over time, which intention could change with little or no notice;
- PrairieSky's NCIB and specifically the volume and value of future repurchases under the NCIB based on current and forecast funds from operations;
- the manner in which PrairieSky manages collection and credit risk and its belief that the diversity of payors and products mitigate this risk;
- possible revisions to accrued estimates based on receipt of actual results;
- impact of compliance activities and recoveries, which vary quarterly;
- impact of bonus consideration, which varies quarterly;
- the Company's estimates of production curtailments in Alberta, and shut-in production across the Royalty Properties, and the impacts thereof, as well as the timing for third-party operators to bring these volumes back on production;
- the estimated impact of shut-in oil volumes on associated solution gas, and the possibility of these gas volumes returning;
- the Company's estimate regarding operators' approach to budgets and capital spending;
- impact of PrairieSky's share price on administrative expenses;
- the expectation that there will be no operating costs, capital costs, environmental liabilities, or abandonment and reclamation obligations associated with development of the Royalty Properties;
- changes to the legislative and regulatory frameworks in the jurisdictions in which the Company carries on a business;
- changes to Alberta provincial income tax rates, including the Provincial Government's intention to table legislation to escalate the provincial income tax rate change;
- the ability to mitigate the risks of fluctuations in commodity prices and production volumes, including but not limited to impacts from a slowdown in both drilling and workover activity; and
- average production contributions from the Royalty Properties including the impact of declines.

By their nature, forward-looking statements are subject to numerous risks and uncertainties, some of which are beyond our control, including the impact of general economic conditions, industry conditions, the trajectory of the global COVID-19 pandemic, volatility of commodity prices, lack of pipeline capacity, currency fluctuations, imprecision of reserve estimates, royalties, environmental risks, taxation, regulation, changes in tax or other legislation, political and geopolitical instability, competition from other industry participants, the lack of availability of qualified personnel or management, stock market volatility, and our ability to access sufficient capital from internal and external sources. In addition, PrairieSky is subject to numerous risks and uncertainties in relation to acquisitions. These risks and uncertainties include risks relating to title to the assets acquired and the potential for disputes to arise with third parties, and limited ability to recover indemnification from such third parties under certain agreements. The foregoing and other risks are described in more detail in PrairieSky's Annual Information Form and in this MD&A under the heading "Risk Management".

With respect to forward-looking statements contained in this MD&A, we have made assumptions regarding, among other things, the ability of the lessees and working interest owners on the Royalty Properties to maintain or increase production and reserves from these properties; the ability and willingness of the lessees and working interest owners on the Royalty Properties to comply with, and PrairieSky to enforce, lease terms and contractual provisions, as applicable, in order to receive payments; the ability of the lessees or working interest owners on the Royalty Properties to operate in a safe, efficient and effective manner; the timely receipt of any required regulatory approvals by lessees or working interest owners on the Royalty Properties; the willingness and financial capability of the lessees and working interest owners to continue to develop and invest additional capital in the Royalty Properties; the ability of the lessees and working interest owners on the Royalty Properties to obtain financing on acceptable terms to fund capital expenditures; field production

rates, decline rates and the well performance and characteristics of the Royalty Properties; the ability to replace and increase crude oil, natural gas and NGL reserves and production associated with the Royalty Properties through third-party development and complementary acquisitions; the timing, cost and ability of third parties to access, maintain or expand necessary facilities and/or secure adequate product transportation and storage; the ability of the third-party operators on the Royalty Properties to successfully market their respective petroleum and natural gas products or, for royalty payments taken-in-kind by PrairieSky, the ability of PrairieSky or a third-party marketer to successfully market PrairieSky's in-kind petroleum and natural gas products; surface rights access being granted to third parties on PrairieSky's properties; the benefits of the seismic data anticipated to be used by PrairieSky and sub-licensed to lessees on the Royalty Properties; the level of costs and expenses to be incurred by PrairieSky, including with respect to interest, production and mineral taxes, administrative expenses and income taxes; the ability of PrairieSky to obtain and retain qualified staff and services in a timely and cost efficient manner; the absence of any material litigation or claims against or involving PrairieSky; the general stability of the economic and political environment and the regulatory framework regarding royalties, taxes and environmental matters in the jurisdictions in which PrairieSky has an interest in crude oil and natural gas properties; future crude oil, natural gas and NGL prices and currency exchange and interest rates; the effects of COVID-19 on global crude oil demand and pricing as well as local and global social and economic conditions; and PrairieSky's ability to execute the volume and/or value of purchases as described under the NCIB or future NCIBs.

Readers are cautioned that the assumptions used in the preparation of such forward-looking information and statements, although considered reasonable at the time of preparation, may prove to be imprecise and, as such, undue reliance should not be placed on forward-looking statements. Our actual results, performance, or achievement could differ materially from those expressed in, or implied by, these forward-looking statements. We can give no assurance that any of the events anticipated will transpire or occur, or if any of them do, what benefits we will derive from them. Statements relating to "reserves" are deemed to be forward-looking statements as they involve the implied assessment, based on certain estimates and assumptions that the reserves described can be profitably produced in the future. Readers are cautioned that the foregoing lists of factors are not exhaustive.

**Any forward-looking statement is made only as of the date of this MD&A, and PrairieSky undertakes no obligation to update or revise any forward-looking statement or statements to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events, except as required by applicable securities laws. New factors emerge from time to time, and it is not possible for PrairieSky to predict all of these factors or to assess in advance the impact of each such factor on PrairieSky's business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.**

**The forward-looking information contained in this MD&A is expressly qualified by this cautionary statement.**

You are further cautioned that the preparation of consolidated financial statements in accordance with IFRS requires management to make certain judgments and estimates that affect the reported amounts of assets, liabilities, revenues, and expenses. These estimates may change, having either a positive or negative effect on net earnings, as further information becomes available and as the economic environment changes.

## **CONVERSIONS OF NATURAL GAS TO BOE**

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To provide a single unit of production for analytical purposes, natural gas production and reserves volumes are converted mathematically to equivalent barrels of oil (BOE). We use the industry-accepted standard conversion of six thousand cubic feet of natural gas to one barrel of oil (6 Mcf = 1 bbl). The 6:1 BOE ratio is based on an energy equivalency conversion method primarily applicable at the burner tip. It does not represent a value equivalency at the wellhead and is not based on either energy content or current prices. While the BOE ratio is useful for comparative measures and observing trends, it does not accurately reflect individual product values and might be misleading, particularly if used in isolation. As well, given that the value ratio, based on the current price of crude oil to natural gas, is significantly different from the 6:1 energy equivalency ratio, using a 6:1 conversion ratio may be misleading as an indication of value.

## **CURRENCY AND REFERENCES TO PRAIRIESKY**

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All information included in this MD&A, and the interim condensed consolidated financial statements is shown on a Canadian dollar basis.

For convenience, references in this document to the "Company", "we", "us", "our", and "its" may, where applicable, refer only to PrairieSky.

## **ADDITIONAL INFORMATION**

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Additional information about PrairieSky, including the 2019 audited annual consolidated financial statements and notes thereto, and PrairieSky's Annual Information Form, is available on SEDAR at [www.sedar.com](http://www.sedar.com) or PrairieSky's website at [www.prairiesky.com](http://www.prairiesky.com).