

FIRST QUARTER INTERIM REPORT

For the three months ended March 31, 2020



Performance Data

| Three Months Ended March 31, | 2020 | 2019 | Change |
|---|---------------|--------|-----------|
| (CDN 000s, except per share data) (unaudited) | (\$) | (\$) | (%) |
| Revenue | 73,962 | 82,143 | (10) |
| EBITDA ^(1,2) | 33,469 | 40,435 | (17) |
| Adjusted EBITDA ^(1,2) | 33,305 | 40,799 | (18) |
| As a % of revenue | 45.0 | 49.7 | (470) bps |
| Funds flow from operations | 26,722 | 35,899 | (26) |
| Per share – basic | 0.32 | 0.42 | (24) |
| Per share – diluted | 0.32 | 0.42 | (24) |
| Cash from operating activities | 25,593 | 8,442 | 203 |
| Capital expenditures | 3,088 | 10,317 | (70) |
| Free cash flow ⁽¹⁾ | 22,935 | 385 | n/a |
| Cash dividends declared | 0.19 | 0.18 | 6 |
| Net income | 16,552 | 19,044 | (13) |
| Net income attributable to Pason | 16,919 | 19,044 | (11) |
| Per share – basic | 0.20 | 0.22 | (10) |
| Per share – diluted | 0.20 | 0.22 | (10) |
| Total interest bearing debt | — | — | — |
| Shares outstanding end of period (#000's) | 84,096 | 85,801 | (2) |

(1) Non-IFRS financial measures are defined in the Management's Discussion and Analysis section.

(2) Prior period amounts have been restated to conform with current year's presentation.

Q1 2020 vs Q1 2019

The Company generated consolidated revenue of \$74.0 million in the first quarter of 2020, a decrease of 10% from the corresponding period in 2019. The decrease is attributable to a drop in US industry activity, offset by an increased market share in the US business unit.

Adjusted EBITDA decreased to \$33.3 million in the first quarter, a decrease of 18% from the corresponding period in 2019. The decrease in adjusted EBITDA was driven by the decrease in gross profit in the US business unit, partially offset by an increase in gross profit in the Canadian business unit.

Funds flow from operations was \$26.7 million in the first quarter, a decrease of 26% from the corresponding period in 2019.

Cash from operating activities was \$25.6 million in the first quarter of 2020, an increase of \$17.2 million from the corresponding period in 2019. In 2019, the Company made a \$15.3 million withholding tax payment to the CRA.

Free cash flow was \$22.9 million in the first quarter of 2020, compared to \$0.4 million from the corresponding period in 2019. In 2019, free cash flow was negatively affected by the operating activities described above and higher capital expenditures in the US business unit.

The Company recorded net income attributable to Pason of \$16.9 million (\$0.20 per share) in the first quarter of 2020 compared to net income attributable to Pason of \$19.0 million (\$0.22 per share) recorded in the corresponding period in 2019. The drop in US industry activity, combined with the Company's fixed cost structure, led to a drop in net income. These factors were offset by lower stock-based compensation expense in the first quarter of 2020 relative to the corresponding period in 2019.

President's Message

The first quarter of 2020 started relatively strong, when the unprecedented impact of COVID-19 on global oil demand was not yet clear. As the global economy was shutting down, a disagreement between Russia and Saudi Arabia over proposed production cuts led to an increase in supply at the worst possible time and a collapse of oil prices. The result was that the end of the first quarter 2020 became anemic for the industry.

Accordingly, Pason's operating environment deteriorated in the period with drilling industry activity decreasing by 25% in the United States compared to the same period in 2019. This headwind was partially offset by 7% higher industry activity in Canada, market share gains in the United States, and continued growth in product penetration in all geographies. Revenue per EDR Day for the quarter increased in both the United States and Canada.

Pason generated revenue of \$74.0 million in the period, a decrease of 10% compared to the same quarter of last year. Adjusted EBITDA was \$33.3 million for the quarter, a decrease of 18%. Adjusted EBITDA as a percentage of revenue was 45% compared to 50% one year ago, highlighting our largely fixed cost structure. Net income attributable to Pason for the quarter was \$16.9 million (\$0.20 per share), down from \$19.0 million (\$0.22 per share) in the first quarter of 2019. Capital expenditures for the quarter were \$3.0 million and free cash flow was \$22.9 million. At March 31, 2020, our working capital position stood at \$208 million, including cash and short-term investments of \$170 million.

The Company and its Board of Directors are actively assessing an optimal cost structure and capital allocation strategy, including the levels of future dividends, in order to balance the Company's commitment to shareholder returns while preserving its financial strength. Pason will maintain the quarterly dividend to be paid on June 29, 2020 at \$0.19 per share and in light of the uncertainties related to COVID-19 and the significant negative impact that a weakened commodity price environment have on the outlook for industry activity, we currently intend to reduce the next quarterly dividend, expected to be declared following the second quarter, to \$0.05 per share.

Pason recognizes the uncertainties and concerns caused by the COVID-19 pandemic. The Company is considered an "essential critical infrastructure" company in the United States and an "essential service" in Canada. As such, we continue to support drilling operations and technology solutions, providing valuable services to our customers in support of the global energy infrastructure. The health and safety of all Pason stakeholders - our employees, customers, and vendors, remain a top priority for us. Accordingly, Pason has implemented additional policies and procedures to protect the well-being of our stakeholders. To minimize the impact of COVID-19 on our ongoing operations, we began working remotely where possible since March 16th. We are proud of how our people have responded in these challenging times.

Pason will continue to make operationally sound and fiscally conservative decisions to support our long-term success. In light of the uncertainties related to the outlook for industry activity, Pason has reassessed its cost structure, as well as capital expenditures, for the remainder of 2020. We intend to make reductions to operating and other expenses during the second quarter while retaining key capabilities, people and relationships to strengthen our competitive position for the future. We now intend to spend approximately \$10 million in capital expenditures in 2020, which includes the capitalized portion of R&D, down from \$25 million announced at the beginning of the year.

Going forward, we will allocate capital to safeguard the long-term prospects of Pason's core drilling-related business and of Energy Toolbase, our foothold in the solar and energy storage market.

The energy world has been upended by the two 2020 oil black swans - a demand collapse and a supply surge. Survival has become the primary focus of many E&P and oilfield service companies. Significantly reduced cash flows for every company in the industry, including Pason, are unavoidable in the short term. However, this environment also provides an opportunity for the strongest companies, such as Pason, to become even stronger by leapfrogging competition in terms of technology and service, and opportunities may emerge to acquire high-quality assets and business lines. As the macro environment for oil corrects over the next 18 to 24 months, the focus will again shift to the long-term future.

Pason will survive and we are confident that we will make it through this much better and stronger than our competitors and peers.

A handwritten signature in black ink, appearing to read "Marcel Kessler", with a stylized flourish at the end.

Marcel Kessler
President and Chief Executive Officer
April 30, 2020

Management's Discussion and Analysis

The following discussion and analysis has been prepared by management as of April 30, 2020, and is a review of the financial condition and results of operations of Pason Systems Inc. (Pason or the Company) based on International Financial Reporting Standards (IFRS) and should be read in conjunction with the Consolidated Financial Statements and accompanying notes.

Certain information regarding the Company contained herein may constitute forward-looking statements under applicable securities laws. Such statements are subject to known or unknown risks and uncertainties that may cause actual results to differ materially from those anticipated or implied in the forward-looking statements.

All financial measures presented in this report are expressed in Canadian dollars unless otherwise indicated.

Impact of Hyperinflation

In 2018, the Company concluded that its Argentinian subsidiary is operating in a hyperinflationary economy. This conclusion impacts the application of two accounting standards, IAS 21, The Effects of Changes in Foreign Exchange, and IAS 29, Financial Reporting in Hyperinflationary Economies.

The impact of applying IAS 21 to the operating results of Argentina subsidiary for the first quarter of 2020 was to increase revenue by \$93 and reduce segment gross profit by \$106. The impact of applying IAS 29 to the non-monetary assets and liabilities, and shareholders' equity of the Argentina subsidiary was to record a non-cash net monetary adjustment of \$419 for the three months ended March 31, 2020. The impact of applying these two standards on the comparative period in 2019 was not material.

Impact on IFRS Measures

| Three Months Ended March 31, | 2020 |
|---|--------------|
| (000s) (unaudited) | (\$) |
| Increase in revenue | 93 |
| (Increase) in rental services and local administration expenses | (55) |
| (Increase) in depreciation expense | (144) |
| (Decrease) in segment gross profit | (106) |
| Net monetary gain presented in other expenses | 419 |
| Increase in other expenses | (11) |
| (Increase) in income tax expenses | (12) |
| Increase in net income | 290 |

Impact on Non-IFRS Measures

| Three Months Ended March 31, | 2020 |
|---|-------------|
| (000s) (unaudited) | (\$) |
| Increase in revenue | 93 |
| (Increase) in rental services and local administration expenses | (55) |
| Net monetary gain presented in other expenses | 419 |
| Increase in other expenses | (11) |
| Increase in EBITDA | 446 |
| (Elimination) of net monetary gain presented in other expenses | (419) |
| (Elimination) of other expenses | 11 |
| Increase in Adjusted EBITDA | 38 |

Additional IFRS Measures

In its Consolidated Financial Statements, the Company uses certain additional IFRS measures. Management believes these measures provide useful supplemental information to readers.

Funds flow from operations

Management believes that funds flow from operations, as reported in the Consolidated Statements of Cash Flows, is a useful additional measure as it represents the cash generated during the period, regardless of the timing of collection of receivables and payment of payables. Funds flow from operations represents the cash flow from continuing operations, excluding non-cash items. Funds flow from operations is defined as net income adjusted for depreciation and amortization expense, non-cash, stock-based compensation expense, deferred taxes, and other non-cash items impacting operations.

Cash from operating activities

Cash from operating activities is defined as funds flow from operations adjusted for changes in working capital items.

Non-IFRS Financial Measures

These definitions are not recognized measures under IFRS, and accordingly, may not be comparable to measures used by other companies. These Non-IFRS measures provide readers with additional information regarding the Company's ability to generate funds to finance its operations, fund its research and development and capital expenditure program, and pay dividends.

Revenue per EDR day

Revenue per EDR day is defined as the daily revenue generated from all products that the Company has on rent on a drilling rig that has the Company's base EDR installed. This metric provides a key measure on the Company's ability to increase production adoption and evaluate product pricing.

EBITDA

EBITDA is defined as net income before interest income and expense, income taxes, stock-based compensation expense, depreciation and amortization expense, and gains on disposal of investments.

Adjusted EBITDA

Adjusted EBITDA is defined as EBITDA, adjusted for foreign exchange, impairment of property, plant, and equipment, restructuring costs, net monetary adjustments, and other items which the Company does not consider to be in the normal course of continuing operations.

Management believes that EBITDA and Adjusted EBITDA are useful supplemental measures as they provide an indication of the results generated by the Company's principal business activities prior to the consideration of how these results are taxed in multiple jurisdictions, how the results are impacted by foreign exchange or how the results are impacted by the Company's accounting policies for equity-based compensation plans.

Free cash flow

Free cash flow is defined as cash from operating activities plus proceeds on disposal of property, plant, and equipment, less capital expenditures (including changes to non-cash working capital associated with capital expenditures), and deferred development costs. This metric provides a key measure on the Company's ability to generate cash from its principal business activities after funding the capital expenditure program, and provides an indication of the amount of cash available to finance, among other items, the Company's dividend and other investment opportunities.

Overall Performance

| Three Months Ended March 31, | 2020 | 2019 | Change |
|------------------------------|---------------|--------|--------|
| (000s) (unaudited) | (\$) | (\$) | (%) |
| Revenue | | | |
| Drilling Data | 38,671 | 43,253 | (11) |
| Mud Management and Safety | 21,397 | 23,674 | (10) |
| Communications | 5,078 | 5,957 | (15) |
| Drilling Intelligence | 5,395 | 5,973 | (10) |
| Analytics and Other | 3,421 | 3,286 | 4 |
| Total revenue | 73,962 | 82,143 | (10) |

The Pason Electronic Drilling Recorder (EDR) remains the Company's primary product. The EDR provides a complete system of drilling data acquisition, data networking, and drilling management tools and reports at both the wellsite and at customer offices. The EDR is the base product from which all other wellsite instrumentation products are linked. By linking these products, a number of otherwise redundant elements such as data processing, display, storage, and networking are eliminated. This ensures greater reliability and a more robust system of instrumentation for the customer.

For the first quarter of 2020, industry activity in the US market decreased by 25% in the first quarter of 2020 compared to the corresponding period in 2019. The US business unit experienced a decline in drilling activity as producers reduced capital spending. For the first quarter of 2020, industry activity in the Canadian market increased by 7% compared to the corresponding period in 2019.

Total revenue decreased by 10% in the first quarter of 2020 compared to the corresponding period in 2019 as a result of a decrease in drilling activity in the US business unit.

Analytics and other revenue increased by 4% in the first quarter of 2020 compared to the corresponding period in 2019 predominantly as a result of the revenue generated from the acquisition of Energy Toolbase Software Inc.

US EDR days decreased by 22% in the first quarter of 2020 compared to the corresponding period in 2019, while Canadian EDR days, which includes non-oil and gas-related activity, remained constant from 2019 levels.

In the first quarter of 2020, the Pason EDR was installed on 64% of the land rigs in the US market, an increase of 300bps over the same period in 2019.

In the first quarter of 2020, the Pason EDR was installed on 89% of the land rigs in the Canadian market, a decrease of 500bps over the same period in 2019. In calculating market share, the Company uses the number of EDR days billed and oil and gas drilling days as reported by accepted industry sources.

Discussion of Operations

United States Operations

| Three Months Ended March 31, | 2020 | 2019 | Change |
|---|---------------|---------------|-------------|
| (000s) (unaudited) | (\$) | (\$) | (%) |
| Revenue | | | |
| Drilling Data | 24,710 | 29,176 | (15) |
| Mud Management and Safety | 14,083 | 17,217 | (18) |
| Communications | 2,274 | 3,229 | (30) |
| Drilling Intelligence | 2,117 | 3,152 | (33) |
| Analytics and Other | 1,803 | 1,691 | 7 |
| Total revenue | 44,987 | 54,465 | (17) |
| Rental services and local administration | 18,052 | 19,090 | (5) |
| Depreciation and amortization | 4,579 | 4,774 | (4) |
| Segment gross profit | 22,356 | 30,601 | (27) |

| Three Months Ended March 31, | 2020 | 2019 | Change |
|--|--------|--------|--------|
| (unaudited) | (#) | (#) | (%) |
| Electronic Drilling Recorder (EDR) Rental Days | 43,700 | 55,700 | (22) |

| Three Months Ended March 31, | 2020 | 2019 | Change |
|------------------------------|-------|------|--------|
| (unaudited) | (\$) | (\$) | (%) |
| Revenue per EDR day - USD | 750 | 728 | 3 |
| Revenue per EDR day - CAD | 1,008 | 968 | 4 |

Revenue from the US operations decreased by 17% in the first quarter of 2020 over the 2019 comparable period (19% when measured in USD).

Analytics and other revenue increased 7% in the first quarter of 2020 over the 2019 comparable period predominantly as a result of the revenue generated from the Energy Toolbase Software Inc. acquisition in the third quarter of 2019.

Industry activity in the US market decreased by 25% in the first quarter of 2020 over the 2019 comparable period. Active rig count declined in most major plays.

US market share was 64% for the first quarter of 2020 compared to 61% during the same period in 2019.

EDR rental days decreased by 22% in the first quarter of 2020 over the 2019 comparable period. Revenue per EDR day increased to US\$750 in the first quarter of 2020, an increase of US\$22 over the same period in 2019. The increase in revenue per EDR day is due to increased adoption of certain products.

Rental services and local administration decreased by 5% in the first quarter of 2020 over the 2019 comparative period. The decrease in operating costs is attributable to the Company managing field and office staff levels to support the current level of activity. Included in the US business segment are the results of Energy Toolbase Software Inc.

Canadian Operations

| Three Months Ended March 31, | 2020 | 2019 | Change |
|---|---------------|--------|--------|
| (000s) (unaudited) | (\$) | (\$) | (%) |
| Revenue | | | |
| Drilling Data | 8,457 | 8,092 | 5 |
| Mud Management and Safety | 5,081 | 4,683 | 8 |
| Communications | 2,355 | 2,292 | 3 |
| Drilling Intelligence | 2,977 | 2,490 | 20 |
| Analytics and Other | 856 | 956 | (10) |
| Total revenue | 19,726 | 18,513 | 7 |
| Rental services and local administration | 5,819 | 5,709 | 2 |
| Depreciation and amortization | 4,796 | 4,555 | 5 |
| Segment gross profit | 9,111 | 8,249 | 10 |

| Three Months Ended March 31, | 2020 | 2019 | Change |
|--|---------------|--------|--------|
| (unaudited) | (#) | (#) | (%) |
| Electronic Drilling Recorder (EDR) Rental Days | 15,500 | 15,500 | — |

| Three Months Ended March 31, | 2020 | 2019 | Change |
|-------------------------------------|--------------|-------|--------|
| (unaudited) | (\$) | (\$) | (%) |
| Revenue per EDR day - CAD | 1,226 | 1,142 | 7 |

Canadian drilling activity in the first quarter of 2020 increased by 7% relative to the same period in 2019, while EDR rental days remained static.

Revenue in the Canadian business unit increased by 7% in the first quarter of 2020 over the 2019 comparative period.

Drilling intelligence revenue increased 20% in the first quarter of 2020 over the 2019 comparative period due to the continued adoption of drilling intelligence products.

Canadian market share was 89% for the first quarter of 2020 relative to 94% in the comparative period in 2019.

Revenue per EDR day increased by \$84 to \$1,226 during the first quarter of 2020 over the 2019 comparative period. The increase is driven by increased usage of drilling intelligence products.

Depreciation and amortization expense increased by 5% in the first quarter of 2020 over the 2019 comparative period. The increase is due to the Company initiating the amortization of previously deferred research and development projects.

Segment gross profit for the first quarter of 2020 increased by 10% to \$9.1 million relative to \$8.2 million in segment gross profit in the 2019 comparative period.

International Operations

| Three Months Ended March 31, | 2020 | 2019 | Change |
|---|--------------|--------------|------------|
| (000s) (unaudited) | (\$) | (\$) | (%) |
| Revenue | | | |
| Drilling Data | 5,504 | 5,985 | (8) |
| Mud Management and Safety | 2,233 | 1,774 | 26 |
| Communications | 449 | 436 | 3 |
| Drilling Intelligence | 301 | 331 | (9) |
| Analytics and Other | 762 | 639 | 19 |
| Total revenue | 9,249 | 9,165 | 1 |
| Rental services and local administration | 5,283 | 5,306 | — |
| Depreciation and amortization | 1,039 | 893 | 16 |
| Segment gross profit | 2,927 | 2,966 | (1) |

Revenue in the International business unit increased by 1% in the first quarter of 2020 compared to the same period in 2019. Activity levels in all of the Company's major international markets remained stable in the first quarter of 2020 over the 2019 comparative period.

Depreciation expense increased by 16% in the first quarter of 2020 compared to the same period in 2019 due to hyperinflation accounting.

Segment gross profit was \$2.9 million for the first quarter of 2020, an decrease of 1% compared to the same period in 2019.

Corporate Expenses

| Three Months Ended March 31, | 2020 | 2019 | Change |
|--|---------------|---------------|-------------|
| (000s) (unaudited) | (\$) | (\$) | (%) |
| Other expenses | | | |
| Research and development | 8,062 | 7,744 | 4 |
| Corporate services | 3,685 | 3,653 | 1 |
| Stock-based compensation | (122) | 3,824 | — |
| Other | | | |
| Foreign exchange loss | (47) | 101 | — |
| Net interest expense - lease liability | 178 | 137 | 30 |
| Interest income - short term investments | (576) | (185) | 211 |
| Net monetary gain | (419) | — | — |
| Equity income | (244) | (158) | 54 |
| Other | 302 | 263 | 15 |
| Total corporate expenses | 10,819 | 15,379 | (30) |

Net monetary gain is as a result of applying hyperinflation accounting to the Company's Argentinian subsidiary.

Stock-based compensation was a recovery in the first quarter of 2020 due to the decrease in the Company's stock price.

Q1 2020 vs Q4 2019

Consolidated revenue was \$74.0 million in the first quarter of 2020 compared to \$68.4 million in the fourth quarter of 2019, an increase of \$5.6 million.

Revenue in the US business unit was \$45.0 million in the first quarter of 2020 compared to \$44.2 million in the fourth quarter of 2019. The increase is attributable to a 200bps increase in market share and the weakening of the Canadian dollar.

Revenue in the Canadian business unit was \$19.7 million in the first quarter of 2020 compared to \$14.2 million in the fourth quarter of 2019. The increase is attributable an increase in market share and industry activity.

The International business unit reported revenue of \$9.2 million in the first quarter of 2020 compared to \$10.0 million in the fourth quarter of 2019. The decrease is attributable to a general decrease in industry activity.

Adjusted EBITDA, which adjusts EBITDA for foreign exchange and certain non-recurring charges, was \$33.3 million in the first quarter of 2020 compared to \$26.6 million in the fourth quarter of 2019. The increase in this financial metric was mostly attributable to the increase in segment gross profit of the Canadian business unit of \$4.6 million.

Funds flow from operations was \$26.7 million in the first quarter of 2020 compared to \$22.1 million in the fourth quarter of 2019.

Stock-based compensation was a recovery of \$0.1 million in the first quarter of 2020 compared to an expense of \$1.5 million in the fourth quarter of 2019.

The Company recorded net income attributable to Pason in the first quarter of 2020 of \$16.9 million (\$0.20 per share) compared to net income attributable to Pason of \$10.4 million (\$0.12 per share) in the fourth quarter of 2019. The increase is mostly attributable to the increase in segment gross profit of the Canadian business unit and the decrease in stock-based compensation.

Summary of Quarterly Results

| Three Months Ended | Jun 30, 2018 | Sept 30, 2018 | Dec 31, 2018 | Mar 31, 2019 | Jun 30, 2019 | Sept 30, 2019 | Dec 31, 2019 | Mar 31, 2020 |
|--|-----------------|------------------|-----------------|-----------------|-----------------|------------------|-----------------|-----------------|
| (000s, except per share data) (unaudited) | (\$) | (\$) | (\$) | (\$) | (\$) | (\$) | (\$) | (\$) |
| Revenue | 68,271 | 82,344 | 81,965 | 82,143 | 72,894 | 72,195 | 68,410 | 73,962 |
| EBITDA ⁽¹⁾ | 23,538 | 44,169 | 38,418 | 40,435 | 25,606 | 33,167 | 25,555 | 33,469 |
| Adjusted EBITDA ⁽¹⁾ | 29,484 | 42,480 | 39,415 | 40,799 | 30,741 | 31,489 | 26,615 | 33,305 |
| Funds flow from operations | 27,836 | 36,039 | 30,711 | 35,899 | 23,794 | 29,899 | 22,126 | 26,722 |
| Per share – basic | 0.33 | 0.42 | 0.36 | 0.42 | 0.28 | 0.35 | 0.26 | 0.32 |
| Per share – diluted | 0.32 | 0.42 | 0.36 | 0.42 | 0.28 | 0.35 | 0.26 | 0.32 |
| Cash from operating activities | 27,617 | 31,809 | 23,407 | 8,442 | 37,938 | 37,453 | 24,714 | 25,593 |
| Free cash flow ⁽¹⁾ | 23,133 | 26,880 | 16,603 | 385 | 32,547 | 33,067 | 19,955 | 22,935 |
| Net Income | 5,479 | 24,386 | 20,720 | 19,044 | 9,245 | 15,418 | 10,096 | 16,552 |
| Net Income attributable to Pason | 5,479 | 24,386 | 20,720 | 19,044 | 9,245 | 15,418 | 10,405 | 16,919 |
| Per share – basic | 0.06 | 0.29 | 0.24 | 0.22 | 0.11 | 0.18 | 0.12 | 0.20 |
| Per share – diluted | 0.06 | 0.28 | 0.24 | 0.22 | 0.11 | 0.18 | 0.12 | 0.20 |

(1) Non-IFRS financial measures are defined in the Management's Discussion and Analysis section.

Reconcile Income to EBITDA

| Three Months Ended | Jun 30, 2018 | Sept 30, 2018 | Dec 31, 2018 | Mar 31, 2019 | Jun 30, 2019 | Sept 30, 2019 | Dec 31, 2019 | Mar 31, 2020 |
|-------------------------------|-----------------|------------------|-----------------|-----------------|-----------------|------------------|-----------------|-----------------|
| (000s) (unaudited) | (\$) | (\$) | (\$) | (\$) | (\$) | (\$) | (\$) | (\$) |
| Net Income | 5,479 | 24,386 | 20,720 | 19,044 | 9,245 | 15,418 | 10,096 | 16,552 |
| Add: | | | | | | | | |
| Income taxes | 5,060 | 8,754 | 7,192 | 7,393 | 3,469 | 5,485 | 3,846 | 7,023 |
| Depreciation and amortization | 9,220 | 8,904 | 7,556 | 10,222 | 9,978 | 9,917 | 10,713 | 10,414 |
| Stock-based compensation | 3,855 | 2,589 | 3,335 | 3,824 | 3,089 | 2,446 | 1,481 | (122) |
| Net interest income | (76) | (464) | (385) | (48) | (175) | (99) | (581) | (398) |
| EBITDA ⁽¹⁾ | 23,538 | 44,169 | 38,418 | 40,435 | 25,606 | 33,167 | 25,555 | 33,469 |

(1) Non-IFRS financial measures are defined in the Management's Discussion and Analysis section.

Reconcile EBITDA to Adjusted EBITDA

| Three Months Ended | Jun 30, 2018 | Sept 30, 2018 | Dec 31, 2018 | Mar 31, 2019 | Jun 30, 2019 | Sept 30, 2019 | Dec 31, 2019 | Mar 31, 2020 |
|--------------------------------|-----------------|------------------|-----------------|-----------------|-----------------|------------------|-----------------|-----------------|
| (000s) (unaudited) | (\$) | (\$) | (\$) | (\$) | (\$) | (\$) | (\$) | (\$) |
| EBITDA | 23,538 | 44,169 | 38,418 | 40,435 | 25,606 | 33,167 | 25,555 | 33,469 |
| Add: | | | | | | | | |
| Foreign exchange loss (gain) | 5,787 | (1,516) | 1,007 | 101 | 553 | 615 | 930 | (47) |
| Derecognition of lease | — | — | — | — | 4,289 | — | — | — |
| Net monetary gain | — | — | — | — | — | (2,376) | (511) | (419) |
| Other | 159 | (173) | (10) | 263 | 293 | 83 | 641 | 302 |
| Adjusted EBITDA ⁽¹⁾ | 29,484 | 42,480 | 39,415 | 40,799 | 30,741 | 31,489 | 26,615 | 33,305 |

(1) Non-IFRS financial measures are defined in the Management's Discussion and Analysis section.

Reconcile cash from operating activities to free cash flow

| Three Months Ended | Jun 30, 2018 | Sept 30, 2018 | Dec 31, 2018 | Mar 31, 2019 | Jun 30, 2019 | Sept 30, 2019 | Dec 31, 2019 | Mar 31, 2020 |
|--|-----------------|------------------|-----------------|-----------------|-----------------|------------------|-----------------|-----------------|
| (000s) (unaudited) | (\$) | (\$) | (\$) | (\$) | (\$) | (\$) | (\$) | (\$) |
| Cash from operating activities | 27,617 | 31,809 | 23,407 | 8,442 | 37,938 | 37,453 | 24,714 | 25,593 |
| Less: | | | | | | | | |
| Net additions to property, plant and equipment | (3,227) | (3,890) | (5,621) | (7,489) | (5,510) | (3,726) | (4,143) | (2,236) |
| Deferred development costs | (1,257) | (1,039) | (1,183) | (568) | 119 | (660) | (616) | (422) |
| Free cash flow ⁽¹⁾ | 23,133 | 26,880 | 16,603 | 385 | 32,547 | 33,067 | 19,955 | 22,935 |

(1) Non-IFRS financial measures are defined in the Management's Discussion and Analysis section.

Pason's quarterly financial results vary quarter to quarter due in part to the seasonality of the oil and gas service industry in Canada, which is somewhat offset by the less seasonal nature of US and International operations. The first quarter is generally the strongest quarter for the Company due to strong activity in Canada, where location access is best during the winter. The second quarter is typically the slowest due to spring break-up in Canada, when many areas are not accessible due to ground conditions, and, therefore, do not permit the movement of heavy equipment. Activity generally increases in the third quarter, depending on the year, as ground conditions have often improved and location access becomes available; however, a rainy summer can have a significant adverse effect on drilling activity. By the fourth quarter, access to most areas in Canada becomes available when the ground freezes. Consequently, the performance of the Company may not be comparable quarter to consecutive quarter, but should be considered on the basis of results for the whole year, or by comparing results in a quarter with results in the corresponding quarter for the previous year.

Liquidity and Capital Resources

| As at March 31, | 2020 | 2019 | Change |
|---|---------|---------|-------------|
| (000s) (unaudited) | (\$) | (\$) | (%) |
| Cash and cash equivalents | 170,330 | 183,931 | (7) |
| Working capital | 207,530 | 258,319 | (20) |
| Funds flow from operations ⁽¹⁾ | 26,722 | 35,899 | (26) |
| Capital expenditures ⁽¹⁾ | 3,088 | 10,317 | (70) |
| As a % of funds flow ^{(1) (2)} | 11.6% | 28.7% | (1,710) bps |

(1) Figures are for the three months ended March 31.

(2) Calculated by dividing capital expenditures by funds flow from operations.

Normal Course Issuer Bid (NCIB)

In 2019, the Company renewed the expiring NCIB, which commenced on December 18, 2019 and expires on December 17, 2020. Under the new NCIB, the Company may purchase for cancellation, from time to time, as the Company considers advisable, up to a maximum of 6,777 common shares, which represent 10% of the public float.

The actual number of common shares that may be purchased for cancellation and the timing of any such purchases will be determined by the Company, subject to a maximum daily purchase limitation of 44 common shares. The Company may make one block purchase per calendar week which exceeds the daily purchase restriction.

During the first quarter of 2020, the Company purchased 442 common shares for cancellation (2019: 100), for a total cash consideration of \$3,820 (2019: \$2,022). The total consideration is allocated between share capital and retained earnings.

Intelligent Wellhead System Inc. (IWS)

During the quarter, the Company made a \$5.0 million payment to IWS on the exercise of the first of three put options. As at March 31, 2020, the liability for the two remaining \$5.0 million put options are included in the Condensed Consolidated Interim Balance Sheets under "Investment - put option."

Contractual Obligations

| | Less than 1 year | 1–3 years | Thereafter | Total |
|--------------------------------------|------------------|-----------|------------|--------|
| (000s) (unaudited) | (\$) | (\$) | (\$) | (\$) |
| Operating leases and other contracts | 6,370 | 10,892 | 3,640 | 20,902 |

Contractual obligations relate primarily to minimum future lease payments required primarily for operating leases of certain facilities. A portion of these future obligations have been recognized on the balance sheet as a leased asset and a corresponding liability, in accordance with IRFS 16, Leases.

The Company has available a \$5.0 million demand revolving credit facility. At March 31, 2020, no amount had been drawn on the facility.

Disclosure of Outstanding Share and Options Data

As at March 31, 2020, there were 84,096 common shares and 4,990 options issued and outstanding.

SEDAR

Additional information relating to the Company can be accessed on the Company's website at www.pason.com and on the Canadian Securities Administrators' System for Electronic Document Analysis and Retrieval (SEDAR) at www.sedar.com.

Critical Accounting Estimates

The preparation of the Consolidated Financial Statements requires that certain estimates and judgments be made with respect to the reported amounts of revenue and expenses and the carrying value of assets and liabilities. These estimates are based on historical experience and management's judgments, and as a result, the estimates used by management involve uncertainty and may change as additional experience is acquired.

Depreciation and Amortization

The accounting estimate that has the greatest impact on the Company's financial statements is depreciation and amortization. Depreciation of the Company's capital assets includes estimates of useful lives. These estimates may change with experience over time so that actual results could differ significantly from these estimates.

Carrying Value of Assets

The carrying amounts of the Company's non-financial assets, other than deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. Judgments and assessments are made to determine whether an event has occurred that indicates a possible impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill and intangible assets that have indefinite useful lives or that are not yet available for use, the recoverable amount is estimated each year.

At March 31, 2020, the Company performed an impairment test for goodwill and concluded that there was no impairment. Given the uncertainty facing the oil and gas industry, as a result of COVID-19 and over-supply of oil, the Company will re-assess its assumptions and, if warranted, will perform another impairment test at June 30, 2020.

Stock-Based Payments

The fair value of stock-based payments is calculated using a Black-Scholes option pricing model. There are a number of estimates used in the calculation, such as the future forfeiture rate, expected option life, and the future price volatility of the underlying security, which can vary from actual future events. The factors applied in the calculation are management's best estimates based on historical information and future forecasts.

Income Taxes

The calculation of deferred income taxes is based on a number of assumptions, including estimating the future periods in which temporary differences, tax losses, and other tax credits will reverse. Tax interpretations, regulations, and legislation in the various jurisdictions in which the Company and its subsidiaries operate are subject to change.

The estimation of deferred tax assets and liabilities includes uncertainty with respect to the reversal of temporary differences.

Deferred tax assets are recognized for the carry-forward of unused tax losses and unused tax credits when it is probable that taxable income will be available to utilize unused tax losses and unused tax credits. This requires estimation of future taxable income and usage of tax loss carry-forwards for a considerable period into the future. Income tax expense in future periods may be affected to the extent actual taxable income is not sufficient or available to use the temporary differences giving rise to the deferred tax asset.

Risk and Uncertainties

Pason has implemented a risk management framework that helps the Company manage the reality that future events, decisions, or actions may cause undesirable effects. The framework takes a value-based approach to identifying, prioritizing, communicating, mitigating, and monitoring risks, and aligns this with the organization's appetite for risk considering our culture, strategy, and objectives.

Although a framework can help the Company to manage its risks, the Company's performance is subject to a variety of risks and uncertainties. Although the risks described below are the risks that we believe are material, there may also be risks of which we are currently unaware, or that we currently regard as immaterial based upon the information available to us. Interested parties should be aware that the occurrence of the events described in these risk factors could have a material adverse effect on our business, operating results, and financial condition.

COVID-19

On March 11th, 2020, the World Health Organization declared the COVID-19 outbreak a pandemic. COVID-19's negative impact on the demand for oil has been significant and this combined with an over-supply of oil has led to the lowest oil prices in 20 years. As a result, Pason customers have reduced their capital expenditure programs which has led to a precipitous fall in the active rig count in Pason's major markets. This demand /supply imbalance will have a direct impact on Pason's revenue in the near-term. The ultimate impact of COVID-19 on future oil demand is unknown at the present time and thus it is not possible to predict the long-term effects of COVID-19 on the Company's operating results.

Operating Risks

Pason derives the majority of its revenue from the rental of instrumentation and data services to oil and gas companies and drilling contractors in Canada, the US, Australia, and Latin America. The demand for our products is directly related to land-based or offshore drilling activity funded by energy companies' capital expenditure programs. A substantial or extended decline in energy prices or diversion of funds to large capital programs could adversely affect capital available for drilling activities, directly impacting Pason's revenue.

Commodity Prices

Prices for crude oil and natural gas fluctuate in response to a number of factors beyond Pason's control. The factors that affect prices include, but are not limited to, the following: the actions of the Organization of Petroleum Exporting Countries, world economic conditions, government regulation, political stability in the Middle East and elsewhere, the foreign supply of crude oil, the price of foreign imports, the availability of alternate fuel sources, and weather conditions. Any of these can reduce the amount of drilling activity.

Seasonality

Drilling activity in Canada is seasonal due to weather that limits access to leases in the spring and summer, making the first and last quarters of each year the peak level of demand for Pason's services due to the higher level of drilling activity. The length of the drilling season can be shortened due to warmer winter weather or rainy seasons. Pason can offset some of this risk, although not eliminate it, through continued growth in the US and internationally, where activity is less seasonal.

Proprietary Rights

Pason relies on innovative technologies and products to protect its competitive position in the market. To protect Pason's intellectual property, the Company employs trademarks, patents, employment agreements, and other measures to protect trade secrets and confidentiality of information. Pason also believes that due to the rapid pace of technological change in the industry, technical expertise, knowledge, and innovative skills, combined with an ability to rapidly develop, produce, enhance, and market products, also provides protection in maintaining a competitive position.

Litigation

The Company is involved in various claims and litigation arising in the normal course of business. While the outcome of these matters is uncertain and there can be no assurance that such matters will be resolved in Pason's favour, the Company does not currently believe that the outcome of any pending or threatened proceedings related to these or other matters, or the amounts which the Company may be required to pay by reason thereof, would individually or in the aggregate have a material adverse impact on its day-to-day business operations.

Credit Risk

Pason is exposed to credit risk to the extent that its customers, operating primarily in the oil and natural gas industry, may experience financial difficulty and be unable to meet their obligations. However, Pason has a large number of customers on both the Operator and Contractor side, which minimizes exposure to any single customer.

Availability of Qualified Personnel

Due to the specialized and technical nature of Pason's business, Pason is highly dependent on attracting and retaining qualified or key personnel. There is competition for qualified personnel in the areas where Pason operates, and there can be no assurance that qualified personnel can be attracted or retained to meet the growth needs of the business. To mitigate this risk, Pason has a Human Resources department within each significant business unit to support that function.

Alternative Energies

There continues to be extensive discussion at all levels of government worldwide and by the public concerning the burning of fossil fuels and the impact this may have on the global environment. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability, which could lead to potentially increased capital expenditures and operating costs. Implementation of strategies for reducing greenhouse gases could have a material impact on the nature of operations of the Company. Given the evolving nature of the debate related to climate change and the control of greenhouse gases and the possible resulting requirements, it is not possible to predict either the nature of those requirements or the impact on the Company.

International Operations

Assets outside of Canada and the US may be adversely affected by changes in governmental policy, social instability, or other political or economic developments beyond the Company's control, including expropriation of property, exchange rate fluctuations, and restrictions on repatriation of cash. The Company has mitigated these risks where practical and considered warranted. Approximately 90% of the Company's revenues are generated in Canada and the US, which limits exposure to risks and uncertainties in foreign countries. The Company's Argentinian subsidiary is operating in a highly inflationary economy and its operating results are being impacted by a weakening Argentina peso relative to the Canadian dollar.

Foreign Exchange Exposure

The Company operates internationally and is primarily exposed to exchange risk relative to the US dollar. The Canadian operations are exposed to currency risk on US denominated financial assets and liabilities with fluctuations in the rate recognized as foreign exchange gains or losses in the Consolidated Statements of Operations. The Company's self-sustaining foreign subsidiaries expose the Company to exchange rate risk on the translation of their financial assets and liabilities to Canadian dollars for consolidation purposes.

Adjustments arising when translating the foreign subsidiaries into Canadian dollars are reflected in the Consolidated Statements of Operations and Other Comprehensive Income as unrealized foreign currency translation adjustments. The Company has not hedged either one of these risks.

The Company does not employ any financial instruments to manage risk or hedge its activities. The vast majority of the Company's activities are conducted in Canada and the US, where local revenue is earned against local expenses and the Company is therefore naturally hedged.

Major Customers

Pason has a large customer base, consisting of both operators and contractors, and does not rely on any single customer for a significant portion of its revenue. No single customer accounted for more than 10% of the consolidated revenues of the Company. The loss of one or more customers, or a reduction in the amount of business Pason does with any of its customers, if not offset by obtaining new customers or increasing the amount of business it does with existing customers, could have a detrimental impact on Pason's revenue.

Key Personnel

Pason's success depends to a significant extent on the contributions of a number of its officers and key employees. The Company does not carry "key person" insurance on any of its key employees. As such, the loss of services of one or more of these key employees could have a material adverse effect on Pason's business, operating results, or financial condition.

Dividends

The decision to pay dividends and the amount paid is at the discretion of Pason's Board of Directors, which regularly reviews the Company's financial position, operating results, and industry outlook. Pason's ability to pay dividends is dependent on the Company's ability to generate cash flow in excess of its operating and investment needs and the Company's financial position.

Taxation

Pason and its subsidiaries are subject to income and other forms of taxation in the various jurisdictions in which they operate. Pason attempts to structure its operations in a tax efficient manner in light of prevailing tax regimes. Any adverse change to existing taxation measures, policies or regulations, or the introduction of new taxation measures, policies or regulations in any of the jurisdictions in which Pason operates could have a negative impact on Pason's business, operating results, or financial condition.

The management of Pason believes that the provision for income taxes is adequate and in accordance with both generally accepted accounting principles and appropriate regulations. However, the tax filing positions of the Company are subject to review and audit by tax authorities who may challenge and succeed in management's interpretation of the applicable tax legislation.

Information Security

Pason's business operations use an extensive network of communications and computer hardware and software systems. In addition, Pason's equipment captures, transmits, and stores significant quantities of drilling data on behalf of its customers. The Company takes measures to protect the security and integrity of its information systems and data, however, there is a risk that these measures may not fully protect against a potential security breach, which could have a negative impact on the Company's ability to operate or its reputation with existing and potential customers.

Corporate Information

Directors

James D. Hill
Chairman of the Board
Pason Systems Inc.
Calgary, Alberta

James B. Howe⁽¹⁾⁽⁶⁾⁽⁷⁾
President
Bragg Creek Financial
Consultants Ltd.
Calgary, Alberta

Marcel Kessler
President & CEO
Pason Systems Inc.
Calgary, Alberta

T. Jay Collins⁽²⁾⁽³⁾
Director
Oceaneering International Inc.
Houston, Texas

Judi Hess⁽⁴⁾⁽⁵⁾
CEO & Director
Copperleaf Technologies Inc.
Vancouver, British Columbia

Laura Schwinn⁽²⁾⁽⁴⁾⁽⁶⁾
President Specialty Catalysts
W. R. Grace & Co.
Columbia, Maryland

(1) Audit Committee Chair

(2) Audit Committee Member

(3) HR and Compensation Committee Chair

(4) HR and Compensation Committee Member

(5) Corporate Governance and Nominations Committee Chair

(6) Corporate Governance and Nomination Committee Member

(7) Lead Director

Officers & Key Personnel

Marcel Kessler
President
& Chief Executive Officer

Jon Faber
Chief Financial Officer

David Elliott
Vice President, Finance

Timur Kuru
Vice President, Operations – United States

Bryce McLean
Vice President, Operations – Canada

Russell Smith
Vice President, Operations – International & Offshore

Ryan Van Beurden
Vice President, Rig-site Research & Development

Lars Olesen
Vice President, Product Management

Kevin Boston
Vice President, Business Development

Reid Wuntke
President, Energy Toolbase Software Inc.

Natalie Fenez
Vice President, Legal & Corporate Secretary

Fiona Mueller-Thode
President, Verdazo Analytics Inc.

Corporate Head Office

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Auditors

Deloitte LLP
Calgary, Alberta

Banker

Royal Bank of Canada
Calgary, Alberta

Registrar and Transfer Agent

Computershare Trust Company of Canada
Calgary, Alberta

Stock Trading

Toronto Stock Exchange
Trading Symbol: PSI.TO

Eligible Dividend Designation

Pursuant to the Canadian Income Tax Act, dividends paid by the Company to Canadian residents are considered to be “eligible” dividends.