

# Management's Discussion and Analysis

*The following Management's Discussion and Analysis (MD&A) was prepared as of March 4, 2021 and is management's opinion about the consolidated operating and financial results of Freehold Royalties Ltd. and its wholly-owned subsidiaries (collectively, Freehold or the Company) for the year ended December 31, 2020, and the outlook for Freehold based on information available as of the date hereof.*

The financial information contained herein was based on information in the consolidated financial statements, which have been prepared in accordance with International Financial Reporting Standards (IFRS), which are the Canadian generally accepted accounting principles (GAAP) for publicly accountable enterprises. All comparative percentages are between the years ended December 31, 2020 and 2019, and all dollar amounts are expressed in Canadian currency, unless otherwise noted. References to "US\$" are to United States (U.S.) dollars. This MD&A should be read in conjunction with the audited financial statements and notes.

Additional information about Freehold, including its Annual Information Form for the year ended December 31, 2020 (AIF), once filed, can be found on SEDAR at [www.sedar.com](http://www.sedar.com) and on its website at [www.freeholdroyalties.com](http://www.freeholdroyalties.com).

This MD&A contains the following non-GAAP financial measures: **operating income** and its associated per boe measure **operating netback, payout ratio, free cash flow** and **cash costs**. These are useful supplemental measures to analyze operating performance, financial leverage, and liquidity, among others. However, these terms do not have any standardized meanings prescribed by GAAP and therefore may not be comparable with the calculations of similar measures for other entities. In addition, this MD&A contains forward-looking statements that are intended to help readers better understand Freehold's business and prospects. Readers are cautioned that the MD&A should be read in conjunction with Freehold's disclosure under "Non-GAAP Financial Measures" and "Forward-Looking Statements" included at the end of this MD&A.

## Business Overview

Freehold is incorporated under the laws of the Province of Alberta and trades on the Toronto Stock Exchange under the symbol FRU. We receive revenue from oil and natural gas properties as reserves are produced over the life of the properties. Freehold's primary focus is acquiring and managing oil and natural gas royalties.

## The Royalty Advantage

We manage one of the largest non-government portfolios of oil and natural gas royalties in Canada with an expanding land base in the United States, uniquely positioning Freehold as a North American royalty company. Our total land holdings encompass approximately 6.3 million gross acres, greater than 99% of which are royalty lands. Freehold's mineral title lands (including royalty assumption lands), which we own in perpetuity, cover approximately 1.1 million acres (over 570,000 acres are undeveloped) and we have gross overriding royalty and other interests in approximately 5.2 million acres.

We have royalty interests in more than 12,000 producing wells and 350 units spanning five provinces and eight states and receive royalty income from approximately 350 industry operators throughout North America. Our revenues also include potash, bonus consideration and lease rental income streams that diversify our royalty revenue portfolio.

Royalty rates vary from less than 1.0% (for some gross overriding royalties) to 22.5% (for some lessor royalties). Our North American land base lowers Freehold's risk, and as a royalty owner, it benefits from the drilling activity of others without any capital investments.

As a royalty interest owner, Freehold does not pay any of the capital costs to drill and equip the wells for production on its properties, nor does it incur costs to operate the wells, maintain production, and ultimately restore the land to its original state. All of these costs are paid by others. Freehold's receives royalty income from gross production revenue (revenue before any royalty expenses and operating costs are deducted) resulting in strong netbacks.

## Freehold's Strategy

As a leading royalty company, Freehold's objective is to deliver growth and lower risk attractive returns to shareholders over the long term. Freehold accomplishes this by:

- **Creating value**
  - Drive oil and gas development on Freehold's lands through its lease out program and royalty optimization
  - Acquire royalty assets with acceptable risk profiles and long economic life
  - Generate gross overriding royalties for revenue growth
- **Enhancing value**
  - Maximize Freehold's royalty interests through a comprehensive audit and compliance program
  - Manage Freehold's debt prudently with a target below 1.5 times net debt to funds from operations
- **Delivering value**
  - Target a dividend with an adjusted payout ratio of 60%-80%

## Outlook

### Business Environment

2020 was a significant year for Freehold, one in which we undertook a number of key initiatives to underpin the long-term sustainability of our business and reinforce Freehold's identity as a lower risk income vehicle for our shareholders. This was accomplished despite the challenging backdrop of COVID-19 and the sharp decline in oil prices.

Although it was a significant year, 2020 also represented a challenging year for the oil and gas sector as the emergence of COVID-19 and the concurrent oil price decline impacted both Freehold's funds from operations and production from our royalty lands. As the underlying business environment weakened, we responded to headwinds by making necessary adjustments to ensure the sustainability of our dividend and balance sheet, managing the near-term risk, with the goal of preserving Freehold's identity as a lower risk income vehicle for our shareholders. We want to thank our employees for their patience and willingness to adapt during this period of uncertainty; their efforts have contributed significantly to the positive outlook we have moving forward.

On the commodity front, West Texas Intermediate (WTI) prices averaged US\$39.23/bbl for 2020, down approximately 31% when compared to 2019. Prices ended the year averaging US\$42.47/bbl in Q4-2020 and have displayed strong upward momentum since the lows in April. The macroenvironment for much of 2020 was dominated by weakened demand associated with COVID-19, further exacerbated by a supply war within OPEC plus that reduced WTI prices to multi-decade lows. Since making the necessary supply cuts, which included production curtailments within OPEC and

material shut-in of volumes worldwide, much of the focus driving the price rebound in H2-2020 has been associated with the progress of COVID-19 vaccines rollouts and the subsequent demand response, as countries attempt to return to life before the pandemic.

In Canada, oil prices mirrored the global benchmarks in 2020 with Edmonton Light Sweet oil averaging \$45.51/bbl, down approximately 35% versus 2019. Similarly, Western Canadian Select (WCS) averaged \$35.64/bbl, down 39% versus 2019. Overall, Canadian fundamentals remain constructive as almost all of the 1.0-1.2 mmbbl/d of production curtailed in response to price weakness has come back online. Increased pipeline throughput along with a ramp-up in crude by rail volumes have helped lower storage levels reducing light and heavy differentials into year-end. In Alberta, provincial curtailments expired at the end of the year.

For the first time in many years, Canadian natural gas prices displayed strong price appreciation with the AECO monthly contract price averaging \$2.23/mcf in 2020, increasing 38% versus 2019. Similar to crude oil, AECO prices strengthened into year-end averaging \$2.76/mcf, up 17% versus the same period in 2019. The AECO market remains well supported by a combination of a more functional tolling and transportation system, E&P producers managing production levels prudently, and further aided by a strong demand environment through the winter months.

The Canadian Association of Drilling Contractors (CAODC) estimate approximately 3,300 wells were drilled in western Canada in 2020, down from approximately 4,900 wells in 2019 and approximately 7,000 wells in 2018. The decline versus previous years was the result of a combination of multi-decade low oil prices and limited liquidity for exploration and development activities. While decline in activity marked a multi-year low, an improvement in the underlying commodity environment is expected to drive modest growth in drilling in 2021. CAODC is currently forecasting an increase of approximately 500 wells drilled in 2021, forecasting approximately 3,800 wells for the year.

## 2021 Guidance

### Our key assumptions for 2021 are as follows:

- With the resurgence in drilling activity on Freehold's lands, we are increasing our 2021 guidance and assuming an average royalty production range of 10,500 boe/d to 11,000 boe/d. Royalty volumes are expected to be weighted approximately 55% oil and NGL's and 45% natural gas.
- We are assuming WTI and Edmonton Light Sweet oil prices of US\$50.00/bbl and \$58.00/bbl respectively, and AECO at \$2.75/mcf.

| 2021 Annual Average                     |            | Guidance Dated<br>Mar. 4, 2021 |               |
|-----------------------------------------|------------|--------------------------------|---------------|
| Royalty production                      | boe/d      |                                | 10,500-11,000 |
| West Texas Intermediate (WTI) crude oil | US\$/bbl   | \$                             | 50.00         |
| Western Canadian Select (WCS) crude oil | Cdn\$/bbl  | \$                             | 58.00         |
| AECO natural gas                        | Cdn\$/Mcf  | \$                             | 2.75          |
| Exchange rate                           | Cdn\$/US\$ | \$                             | 0.79          |

## Subscription Receipts

On December 5, 2020, Freehold issued 12,647,667 subscription receipts at a price of \$4.80 per receipt through a public offering pursuant to Freehold's short form prospectus and a concurrent private placement. The total gross proceeds from these subscription receipts was \$60.7 million. Each subscription receipt entitled the holder to receive: (i) upon

occurrence of all the outstanding conditions precedent to the closing of Freehold's acquisition of certain U.S. based royalty properties (see Subsequent Events), one common share of Freehold; and (ii) a dividend equivalent payment equal to the number of subscription receipts times Freehold's per share cash dividends paid or payable prior to the closing of its acquisition. As Freehold had an obligation to either issue the equivalent number of common shares or refund the subscription receipt proceeds as then held in trust, the Company reported subscription receipts payable and restricted cash of \$60.7 million at December 31, 2020.

## Subsequent Events

### Increase in Monthly Dividend

With an improved outlook for commodity prices and a strengthened business model, Freehold's Board of Directors (the Board) has approved increasing the monthly dividend from \$0.02 to \$0.03 per share, or \$0.36 per share annualized. The \$0.03 per share dividend will commence on April 15, 2021 and will be paid to shareholders of record on March 31, 2021. The dividend is designated as an eligible dividend for Canadian income tax purposes.

Projected 2021 payout levels are below our stated dividend policy, which outlines a 60%-80% payout ratio over the long-term based on forward looking funds from operations. The dividend increase announced today is at a measured pace as, although the commodity price outlook has improved substantially, there is still risk as the supply - demand balance for oil continues to be tenuous. We also see meaningful, high quality, acquisition opportunities across North America and feel it would be prudent to retain financial flexibility to pursue these as we work to continually enhance our portfolio positioning and business strength.

### U.S. Royalty Acquisition

On January 5, 2021, Freehold closed an acquisition of U.S. royalty properties for US\$58 million (\$74.0 million) before customary adjustments and financed by the previously mentioned \$60.7 million of subscription receipt proceeds and utilization of Freehold's credit facilities. The acquisition included exposure to approximately 400,000 gross drilling unit acres of mineral title and overriding royalty interests across 12 basins in eight states; predominantly weighted towards the Permian and Eagle Ford basins. 2021 production associated with the acquired assets is forecast at 1,250 boe/d.

Freehold also closed two additional U.S. royalty transactions subsequent to year-end, complementing our positions in the Bakken and Permian basins. Total consideration associated with these transactions was approximately \$4.7 million and the assets are estimated to add 75 boe/d to 2021 average production.

# Operating and Financial Highlights

| FINANCIAL (\$000s, except as noted)                | Three Months Ended December 31 |            |        | Twelve Months Ended December 31 |            |        |
|----------------------------------------------------|--------------------------------|------------|--------|---------------------------------|------------|--------|
|                                                    | 2020                           | 2019       | Change | 2020                            | 2019       | Change |
| Royalty and other revenue                          | \$ 25,793                      | \$ 36,827  | -30%   | \$ 89,958                       | \$ 140,837 | -36%   |
| Net income (loss)                                  | \$ 373                         | \$ 6,113   | -94%   | \$ (13,931)                     | \$ 5,193   | nm     |
| Per share, basic and diluted (\$) <sup>(1)</sup>   | \$ -                           | \$ 0.05    | -100%  | \$ (0.12)                       | \$ 0.04    | nm     |
| Cash flows from operations                         | \$ 20,610                      | \$ 27,954  | -26%   | \$ 65,767                       | \$ 105,801 | -38%   |
| Funds from operations                              | \$ 22,129                      | \$ 30,659  | -28%   | \$ 72,891                       | \$ 118,098 | -38%   |
| Per share, basic (\$) <sup>(1)</sup>               | \$ 0.19                        | \$ 0.26    | -27%   | \$ 0.61                         | \$ 1.00    | -39%   |
| Acquisitions and related expenditures              | \$ 222                         | \$ 2,727   | -92%   | \$ 7,058                        | \$ 49,689  | -86%   |
| Dividends paid                                     | \$ 5,343                       | \$ 18,675  | -71%   | \$ 39,158                       | \$ 74,663  | -48%   |
| Per share (\$) <sup>(2)</sup>                      | \$ 0.0450                      | \$ 0.1575  | -71%   | \$ 0.3300                       | \$ 0.6300  | -48%   |
| Dividends declared                                 | \$ 5,938                       | \$ 18,683  | -68%   | \$ 35,306                       | \$ 74,663  | -53%   |
| Per share (\$) <sup>(2)</sup>                      | \$ 0.0500                      | \$ 0.1575  | -68%   | \$ 0.2975                       | \$ 0.63    | -53%   |
| Payout ratio <sup>(3)</sup>                        | 24%                            | 61%        | -37%   | 54%                             | 63%        | -9%    |
| Long term debt                                     | \$ 93,000                      | \$ 109,000 | -15%   | \$ 93,000                       | \$ 109,000 | -15%   |
| Net debt                                           | \$ 65,765                      | \$ 94,634  | -31%   | \$ 65,765                       | \$ 94,634  | -31%   |
| Shares outstanding, period end (000s)              | 118,788                        | 118,623    | -      | 118,788                         | 118,623    | -      |
| Average shares outstanding (000s) <sup>(1)</sup>   | 118,747                        | 118,568    | -      | 118,685                         | 118,486    | -      |
| <b>OPERATING</b>                                   |                                |            |        |                                 |            |        |
| Royalty production (boe/d) <sup>(4)</sup>          | 9,563                          | 10,315     | -7%    | 9,605                           | 10,229     | -6%    |
| Light and medium oil (bbl/d)                       | 3,239                          | 4,024      | -20%   | 3,449                           | 3,814      | -10%   |
| Heavy oil (bbl/d)                                  | 1,173                          | 1,089      | 8%     | 1,018                           | 1,034      | -2%    |
| NGL (bbl/d)                                        | 813                            | 799        | 2%     | 827                             | 853        | -3%    |
| Total liquids (bbl/d)                              | 5,225                          | 5,912      | -12%   | 5,294                           | 5,701      | -7%    |
| Natural gas (Mcf/d)                                | 26,027                         | 26,416     | -1%    | 25,868                          | 27,166     | -5%    |
| Total production (boe/d) <sup>(4)</sup>            | 9,681                          | 10,740     | -10%   | 9,781                           | 10,628     | -8%    |
| Oil and NGL (%)                                    | 54                             | 57         | -4%    | 55                              | 56         | -2%    |
| Average price realizations (\$/boe) <sup>(4)</sup> | \$ 28.16                       | \$ 37.04   | -24%   | \$ 24.56                        | \$ 35.78   | -31%   |
| Cash costs (\$/boe) <sup>(3)(4)</sup>              | \$ 4.11                        | \$ 5.10    | -19%   | \$ 4.63                         | \$ 5.30    | -13%   |
| Operating netback (\$/boe) <sup>(3)(4)</sup>       | \$ 28.64                       | \$ 36.19   | -21%   | \$ 24.56                        | \$ 35.28   | -30%   |

nm – not meaningful

(1) Weighted average number of shares outstanding during the period, basic

(2) Based on the number of shares issued and outstanding at each record date

(3) See Non-GAAP Financial Measures

(4) See Conversion of Natural Gas to Barrels of Oil Equivalent (boe)

## Fourth Quarter Results Highlights:

- Dividends declared for Q4-2020 totaled \$0.05 per share, down 68% from the same period last year as the 2020 dividend was reduced in May in response to the deteriorating commodity price outlook. Our payout ratio <sup>(1)</sup> totaled 24% for the quarter.
- With decreasing volatility in oil prices and strength in operations, on November 10, 2020, Freehold announced a 33% increase to the monthly dividend to \$0.02 per share (annualized \$0.24 per share). The first payment at the revised dividend level was paid to shareholders on record as of December 31, 2020 on January 15, 2021.
- Funds from operations for Q4-2020 totaled \$22.1 million, a decrease of 28% versus the same period in 2019. This reduction in funds from operations was primarily driven by the 24% reduction in commodity prices over the same period. On a per share basis, funds from operations totaled \$0.19 per share in Q4-2020, down from \$0.26 per share in Q4-2019, however, up from \$0.17 per share in Q3-2020.

- Freehold exited 2020 with long term debt of \$93 million, implying debt to trailing funds from operations of 1.3 times. This compares to \$107 million (same ratio of 1.3 times) and \$109 million (ratio of 0.9 times) in long term debt as of Q3-2020 and year-end 2019, respectively. Despite lower funds from operations causing an increase in this ratio from year-end 2019, the absolute decrease in leverage reflected funds from operations exceeding dividend obligations and acquisition capital.
- Cash costs<sup>(1)</sup> for the quarter totaled \$4.11/boe, up from \$3.70/boe in Q3-2020 but down from \$5.10/boe achieved during the same period last year. The decrease year-over-year reflects the disposition of high cost working interest assets, a reduced debt level, lower interest rates and associated borrowing costs, and lower G&A costs.
- Q4-2020 net income totaled \$0.4 million, driven predominantly by weaker crude oil prices and to a lesser extent, slightly lower royalty production. This compared to \$6.1 million of net income in Q4-2019.
- Freehold's total royalty production averaged 9,563 boe/d, up 5% versus the previous quarter and down 7% versus the same period in 2019.
- Royalty oil production, which has higher operating netbacks<sup>(1)</sup> and returns, averaged 5,225 boe/d in Q4-2020, increasing 4% when compared to the previous quarter and down 12% versus the same period in 2019.
- Wells drilled on our Canadian royalty lands totaled 111 (4.9 net) in the quarter, up on a net measure versus 186 (4.5 net) drilled during the same period in 2019.

(1) See Non-GAAP Financial Measures.

## 2020 Results Highlights:

- Dividends declared for 2020 totaled \$35.3 million (\$0.2975 per share), down 53% versus 2019 when Freehold declared dividends of \$74.7 million (\$0.6300 per share). Our dividend payout for 2020 totaled 54%, at the lower end of our guided dividend payout range. As commodity prices and production volumes on our royalty lands improved through H2-2020 our funds from operations have outperformed expectations resulting in a payout ratio<sup>(1)</sup> of less than 60%.
- Royalty and other revenue totaled \$90.0 million in 2020, down 36% from the previous year as weakness in crude oil prices impacted revenue. Total royalty revenue was comprised of 79% oil and natural gas liquids (NGL's) as we maintained our crude oil and liquids focus.
- Funds from operations in 2020 totaled \$72.9 million or \$0.61 per share, down 38% from \$118.1 million or \$1.00 per share in 2019. The decrease year-over-year reflected weaker crude oil and liquids pricing and lower production volumes versus 2019.
- Freehold completed \$3.3 million in royalty acquisitions in 2020. Much of the focus was associated with smaller tuck-in deals expanding Freehold's position in North Dakota. Subsequent to year-end, Freehold completed its first material U.S. royalty transaction (see Subsequent Events).
- 2020 royalty production averaged 9,605 boe/d, a 6% decrease versus the previous year as reduced full year third-party royalty drilling additions and shut-in production negatively impacted volumes versus 2019. Since late Q2-2020 however, royalty production has displayed steady growth into year-end, as producers have increased capital towards drilling and shut-in volumes have come back on-line on our royalty lands.
- Oil and NGL's volumes represented 55% of 2020 royalty production, down slightly from 56% in 2019 as weakness in crude oil prices during the year resulted in shut-in production which has since been brought back on-stream.

- In total, 372 (13.6 net) wells were drilled on our royalty lands in 2020, a 35% and 42% decrease on a gross and net measure respectively versus 2019. Despite the reduction in drilling year-over-year, Freehold saw a ramp-up in activity during Q4-2020 with 111 gross (4.9 net) wells drilled on our royalty lands, a 9% improvement on a net measure versus the same quarter in 2019. We saw a broadening of producers drilling on our royalty lands over the fourth quarter with southeast Saskatchewan, the Viking, the Cardium and the Sparky in Central Alberta driving much of drilling activity for the period.
- Proved and probable oil and natural gas reserves <sup>(2)</sup> totaled 29.4 MMboe as at December 31, 2020, down from 31.7 MMboe as at December 31, 2019. The slight decrease year-over-year reflected working interest dispositions and production despite additions from tuck-in acquisitions in North Dakota, drilling additions and an on-going evaluation of our undeveloped properties.

(1) See Non-GAAP Financial Measures

(2) A detailed review of Freehold's reserve information, including a summary of the evaluation of Freehold's reserves and associated future net revenues as prepared by Trimble Engineering Associates Ltd., Freehold's independent reserves evaluator effective as at December 31, 2020, is provided in the Annual Information Form (AIF). A copy of the AIF can be found on Freehold's website at [www.freeholdroyalties.com](http://www.freeholdroyalties.com) or [www.sedar.com](http://www.sedar.com).

## Financial and Operating Results

### Drilling Activity

In total, 372 (13.6 net) wells were drilled on Freehold's royalty lands in 2020, 42% and 35% decreases on a gross and net basis, respectively, versus 2019. Overall, Freehold saw reduced drilling activity associated with a more broad reduction in capital spending associated with its royalty payors, although we have seen producers increase capital budgets through H2-2020 and into 2021 as commodity prices have improved.

In Canada and the U.S. during 2020, approximately 49% of gross wells on Freehold royalty lands targeted prospects in Saskatchewan, 40% in Alberta, 11% in Manitoba, and less than 1% in North Dakota. Producers continue to remain focused on oil prospects within Freehold's land base with 87% of wells drilled targeting oil and liquids with 80% of net wells drilled targeting gross overriding royalty (GORR) prospects with the remaining 20% drilled on Freehold's mineral title lands. The Viking in southwest Saskatchewan, Clearwater in central Alberta, Cardium in northwest Alberta and Sparky in central Alberta continue to be key areas of focus with Freehold's top royalty payors remaining well capitalized.

In Q4-2020, Freehold saw 111 gross (4.9 net) wells drilled on Freehold royalty lands which was more than double Q3-2020 activity and an 9% improvement versus the same quarter in 2019. Looking forward, Freehold believes in the quality of both its Canadian and U.S. portfolios and that is expected to drive strong third-party production additions into 2021. The acquisition of additional U.S royalty production and royalty lands subsequent to 2020 is expected to further diversify and enhance Freehold's asset base, bringing added sustainability to its portfolio and dividend.

|       | Three Months Ended December 31 |                    |       |                    | Twelve Months Ended December 31 |                    |       |                    |
|-------|--------------------------------|--------------------|-------|--------------------|---------------------------------|--------------------|-------|--------------------|
|       | 2020                           |                    | 2019  |                    | 2020                            |                    | 2019  |                    |
|       | Gross                          | Net <sup>(1)</sup> | Gross | Net <sup>(1)</sup> | Gross                           | Net <sup>(1)</sup> | Gross | Net <sup>(1)</sup> |
| Total | 111                            | 4.9                | 186   | 4.5                | 372                             | 13.6               | 641   | 20.8               |

(1) Net wells are the equivalent aggregate of the numbers obtained by multiplying each gross well by Freehold's royalty interest percentage.

## Production

Freehold's royalty production averaged 9,605 boe/d for 2020, down approximately 6% versus 2019. This decline was primarily associated with lower crude oil prices during the first half of 2020, which led to reduced drilling on our royalty lands, and increased shut-in production. For Q4-2020, Freehold's royalty production averaged 9,563 boe/d, up 5% quarter-over-quarter. Production volumes were comprised of 45% natural gas, 35% light and medium oil, 11% heavy oil and 9% NGL's.

Working interest production declined 56% in 2020 versus the previous year. The reduction in working interest volumes was largely the result of dispositions in Q2-2020.

### Production Summary

| (boe/d)          | 2020  | 2019   | Change |
|------------------|-------|--------|--------|
| Royalty interest | 9,605 | 10,229 | -6%    |
| Working interest | 176   | 399    | -56%   |
| Total            | 9,781 | 10,628 | -8%    |

### Average Daily Production by Product Type

|                                        | 2020   | 2019   | Change |
|----------------------------------------|--------|--------|--------|
| <b>Royalty interest <sup>(1)</sup></b> |        |        |        |
| Light and medium oil (bbls/d)          | 3,449  | 3,814  | -10%   |
| Heavy oil (bbls/d)                     | 1,018  | 1,034  | -2%    |
| NGL (bbls/d)                           | 827    | 853    | -3%    |
| Natural gas (Mcf/d)                    | 25,868 | 27,166 | -5%    |
| Oil equivalent (boe/d)                 | 9,605  | 10,229 | -6%    |
| <b>Working interest <sup>(1)</sup></b> |        |        |        |
| Light and medium oil (bbls/d)          | -      | 39     | -100%  |
| Heavy oil (bbls/d)                     | 45     | 133    | -66%   |
| NGL (bbls/d)                           | 16     | 32     | -50%   |
| Natural gas (Mcf/d)                    | 690    | 1,167  | -41%   |
| Oil equivalent (boe/d)                 | 176    | 399    | -56%   |
| <b>Total</b>                           |        |        |        |
| Light and medium oil (bbls/d)          | 3,449  | 3,853  | -10%   |
| Heavy oil (bbls/d)                     | 1,063  | 1,167  | -9%    |
| NGL (bbls/d)                           | 843    | 885    | -5%    |
| Natural gas (Mcf/d)                    | 26,558 | 28,333 | -6%    |
| Oil equivalent (boe/d)                 | 9,781  | 10,628 | -8%    |

(1) On certain properties where we have both a royalty interest and a working interest, production is allocated based on the applicable royalty and working interest percentages.

## Product Prices

For 2020, WTI prices averaged US\$39.23/bbl, 31% lower versus the average WTI price realized in 2019. WCS prices averaged \$35.64/bbl in 2020, down 39% versus the same period in 2019. Edmonton Light Sweet price averaged \$45.51/bbl during the year, a 35% decrease versus 2019.

On the natural gas front, AECO prices averaged \$2.23/mcf, up 38% versus last year.

### Average Benchmark

|                                               | 2020 |       | 2019     | Change |
|-----------------------------------------------|------|-------|----------|--------|
| West Texas Intermediate crude oil (US\$/bbl)  | \$   | 39.23 | \$ 56.99 | -31%   |
| Exchange rate (Cdn\$/US\$)                    | \$   | 0.75  | \$ 0.75  | 0%     |
| Edmonton Light Sweet crude oil (Cdn\$/bbl)    | \$   | 45.51 | \$ 69.58 | -35%   |
| Western Canadian Select crude oil (Cdn\$/bbl) | \$   | 35.64 | \$ 58.70 | -39%   |
| AECO monthly contract natural gas (Cdn\$/Mcf) | \$   | 2.23  | \$ 1.62  | 38%    |

The price Freehold receives for its oil production is primarily driven by the U.S. dollar price of WTI. It is also affected by the US\$/Cdn\$ exchange rate, with a decrease in the value of the Canadian dollar relative to the U.S. dollar increasing the revenue received. Freehold's average realized oil prices also reflect product quality and transportation differences from benchmark prices. Freehold's natural gas price realizations are discounted compared to AECO pricing as they, in some cases, include transportation and processing fees netted from certain natural gas royalty payments.

### Average Realized Prices

|                         | 2020 |       | 2019     | Change |
|-------------------------|------|-------|----------|--------|
| Oil (\$/bbl)            | \$   | 39.15 | \$ 61.87 | -37%   |
| NGL (\$/bbl)            | \$   | 22.75 | \$ 31.33 | -27%   |
| Oil and NGL (\$/bbl)    | \$   | 36.57 | \$ 57.29 | -36%   |
| Natural gas (\$/Mcf)    | \$   | 1.67  | \$ 1.48  | 13%    |
| Oil equivalent (\$/boe) | \$   | 24.56 | \$ 35.78 | -31%   |

On a boe basis, Freehold total average selling price was 31% lower in 2020, versus 2019, reflecting the weakness in crude oil benchmark pricing but as partially offset by a 38% increase in the AECO natural gas benchmark.

## Credit Risk Management

Freehold's royalty lands consist of a large number of properties with generally small volumes per property. Many of Freehold's leases and royalty agreements allow it to take its share of oil and natural gas in-kind. As part of Freehold's credit risk mitigation program, Freehold's dedicated Compliance group carefully monitors its royalty receivables and may choose to take its royalty in-kind if there are benefits in doing so. Currently Freehold takes-in-kind and markets approximately 16% of its total royalty production using 30-day contracts. This compares to 12% in 2019, as with the retreat in commodity prices, Freehold has taken a more active approach to mitigating risk within its portfolio.

As the business environment has become more challenged with COVID-19, Freehold's dedicated Compliance group has further increased its scrutiny in its review of potential counterparty risk amongst its payors. Historically Freehold has not experienced significant collection issues.

## Royalty and Other Revenue

Royalty and other revenues of \$90.0 million in 2020 was down from \$140.8 million or 36% relative to 2019. Specifically, royalty interest revenues before bonus consideration and lease rentals of \$87.7 million was down 35% largely due to slightly lower production volumes and reduced commodity prices. Bonus consideration and lease rentals at \$1.6 million for 2020 was consistent with 2019. Working interest revenue before royalty expense of \$1.0 million was down 78% versus 2019 largely as a result of continued dispositions over the year.

### Revenue and other revenue by commodity type

| (\$000s)                              | 2020      | 2019       | Change |
|---------------------------------------|-----------|------------|--------|
| Oil                                   | \$ 64,386 | \$ 113,379 | -43%   |
| Natural gas                           | 16,264    | 15,294     | 6%     |
| NGL                                   | 7,017     | 10,120     | -31%   |
| Potash                                | 1,042     | 1,173      | -11%   |
| Bonus consideration and lease rentals | 1,565     | 1,521      | 3%     |
|                                       | \$ 90,274 | \$ 141,487 | -36%   |
| Royalty expense                       | (316)     | (650)      | -51%   |
| Royalty and other revenues            | \$ 89,958 | \$ 140,837 | -36%   |

### REVENUE AND OTHER REVENUE BY CATEGORY

| (\$000s)                                                               | 2020      | 2019       | Change |
|------------------------------------------------------------------------|-----------|------------|--------|
| Royalty interest revenues before bonus consideration and lease rentals | \$ 87,662 | \$ 135,305 | -35%   |
| Bonus consideration and lease rentals                                  | 1,565     | 1,521      | 3%     |
| Total royalty revenue                                                  | \$ 89,227 | \$ 136,826 | -35%   |
| Working interest revenue before royalty expense                        | 1,047     | 4,661      | -78%   |
| Royalty expense                                                        | (316)     | (650)      | -51%   |
| Royalty and other revenues                                             | \$ 89,958 | \$ 140,837 | -36%   |

## Operating Expenses

Operating expenses are directly associated with Freehold's working interest production activities. Freehold does not incur such costs on production from its royalty lands.

The decrease in operating expenses to \$2.0 million in 2020 from \$3.9 million in 2019 was largely the result of reduced working interest production volumes associated with working interest property dispositions.

| (\$000s, except as noted) | 2020     | 2019     | Change |
|---------------------------|----------|----------|--------|
| Total operating expenses  | \$ 2,032 | \$ 3,945 | -48%   |
| Per boe (\$)              | 0.57     | 1.02     | -44%   |

## Operating Income and Netback

Royalty interests accounted for 99% of royalty and other revenue in 2020 and contributed all operating income.

## 2020 Operating Income <sup>(1)</sup>

| (\$000s)                                       | Twelve months ended December 31, 2020 |                  |           |
|------------------------------------------------|---------------------------------------|------------------|-----------|
|                                                | Royalty Interest                      | Working Interest | Total     |
| Royalty and other revenue <sup>(2)</sup>       | \$ 89,227                             | \$ 1,047         | \$ 90,274 |
| Royalty expense <sup>(3)</sup>                 | (242)                                 | (74)             | (316)     |
| Total royalty and other revenue <sup>(2)</sup> | \$ 88,985                             | \$ 973           | \$ 89,958 |
| Operating expense                              | -                                     | (2,032)          | (2,032)   |
| Operating income                               | \$ 88,985                             | \$ (1,059)       | \$ 87,926 |
| Percentage by category                         | 101%                                  | -1%              | 100%      |

## 2019 Operating Income <sup>(1)</sup>

| (\$000s)                                       | Twelve months ended December 31, 2019 |                  |            |
|------------------------------------------------|---------------------------------------|------------------|------------|
|                                                | Royalty Interest                      | Working Interest | Total      |
| Royalty and other revenue <sup>(2)</sup>       | \$ 136,826                            | \$ 4,661         | \$ 141,487 |
| Royalty expense <sup>(3)</sup>                 | (320)                                 | (330)            | (650)      |
| Total royalty and other revenue <sup>(2)</sup> | \$ 136,506                            | \$ 4,331         | \$ 140,837 |
| Operating expense                              | -                                     | (3,945)          | (3,945)    |
| Operating income                               | \$ 136,506                            | \$ 386           | \$ 136,892 |
| Percentage by category                         | 100%                                  | 0%               | 100%       |

(1) See Non-GAAP Financial Measures.

(2) Royalty interest revenue includes potash, sulphur, bonus consideration, lease rentals, interest and other. Working interest revenue includes processing fees.

(3) Royalty expense includes both Crown charges and royalty payments to third parties.

Freehold's 2020 operating netback, calculated as operating income on a per boe basis totaled \$24.57/boe, down 30% versus 2019. The decrease year-over-year reflected lower oil prices, partly mitigated by sold working interest assets.

## 2020 Operating Netback <sup>(1)</sup>

| (\$000s)          | Twelve months ended December 31, 2020 |                  |          |
|-------------------|---------------------------------------|------------------|----------|
|                   | Royalty Interest                      | Working Interest | Total    |
| Net revenue       | \$ 25.31                              | \$ 15.07         | \$ 25.13 |
| Operating expense | -                                     | (31.48)          | (0.57)   |
| Operating income  | \$ 25.31                              | \$ (16.41)       | \$ 24.56 |

## 2019 Operating Netback <sup>(1)</sup>

| (\$000s)          | Twelve months ended December 31, 2019 |                  |          |
|-------------------|---------------------------------------|------------------|----------|
|                   | Royalty Interest                      | Working Interest | Total    |
| Net revenue       | \$ 36.56                              | \$ 29.73         | \$ 36.30 |
| Operating expense | -                                     | (27.07)          | (1.02)   |
| Operating income  | \$ 36.56                              | \$ 2.66          | \$ 35.28 |

## 2020 vs. 2019 Operating Netback <sup>(1)</sup>

| (\$ per boe)     | 2020     | 2019     | Change |
|------------------|----------|----------|--------|
| Royalty interest | \$ 25.31 | \$ 36.56 | -31%   |
| Working interest | (16.41)  | 2.66     | -717%  |
| Total            | \$ 24.56 | \$ 35.28 | -30%   |

(1) See Non-GAAP Financial Measures.

## General and Administrative Expenses

Freehold has land administration, accounting and auditing requirements to administer and collect royalty payments, including systems to track development activity on its royalty lands. General and administrative (G&A) expenses include directly billed costs in addition to costs incurred by Rife Resources Management Ltd. (the Manager) and allocated to Freehold (see Related Party Transactions).

In 2020, G&A expense totaled \$10.9 million, a 9% decrease compared to \$12.1 million in 2019. G&A expense declined from 2019 due to cost saving initiatives taken as part of efforts to mitigate the impact of weakened commodity prices and the associated impact on Freehold's revenues. These initiatives included reductions in compensation to both the Board and employees in addition to office cost reductions. Freehold's G&A expense includes legal costs associated with our objection to the CRA reassessments (see Income Tax). Capitalized and overhead recoveries increased in 2020 by 25% compared to 2019 due to our on-going purchasing efforts resulting in the recent closing of three U.S. royalty acquisitions (see Subsequent Events).

On a per boe basis, costs were down 2% year-over-year to \$3.05/boe also the result of cost saving initiatives.

| (\$000s, except as noted)                                                          | 2020      | 2019      | Change |
|------------------------------------------------------------------------------------|-----------|-----------|--------|
| General and administrative expenses,<br>before capitalized and overhead recoveries | \$ 13,061 | \$ 13,764 | -5%    |
| Less: capitalized and overhead recoveries                                          | (2,131)   | (1,701)   | 25%    |
| General and administrative expenses                                                | \$ 10,930 | \$ 12,063 | -9%    |
| Per boe (\$)                                                                       | \$ 3.05   | \$ 3.11   | -2%    |

## Share-Based Compensation

Share-based compensation expense associated with Freehold's award and deferred share unit plans was \$1.1 million in 2020 versus \$1.4 million in 2019. This decrease was due to lower Freehold share pricing and recoveries of previously expensed share-based compensation due to forfeitures associated with 2020 staffing level reductions.

| (\$000s, except as noted)          | 2020     | 2019     | Change |
|------------------------------------|----------|----------|--------|
| Share-based and other compensation | \$ 1,071 | \$ 1,408 | -24%   |
| Per boe (\$)                       | 0.30     | 0.36     | -17%   |

## Award Plan

Freehold's award plan is share based and cash settled. Freehold's award plan consists of grants of performance share units (PSUs) and restricted share units (RSUs) pursuant to the Freehold Award Plan (Award Plan).

Share-based compensation expense is based on Freehold's share price, the number of share-based awards outstanding at each period end, a notional adjustment for paid dividends and an estimated forfeiture rate. Compensation expense is recognized over the vesting period. For the PSUs there is also a performance multiplier of 0 to 2 times based upon 50% of an absolute total shareholder return and 50% on a relative total shareholder return over a three-year period.

During 2020 Freehold paid \$0.4 million (2019 - \$0.5 million) and granted 671,689 awards (2019 - 207,194) under these plans resulting in 686,792 outstanding awards at December 31, 2020 and March 4, 2021. The increase in the awarded units was due to the lower 2020 share price.

## Deferred Share Unit Plan

Pursuant to Freehold's deferred share unit plan, fully-vested deferred share units (DSUs) are granted annually in the first quarter to members of the Board of Directors and are redeemable for an equal number of Freehold common shares upon the member's retirement. Dividends paid prior to redemption are reinvested on behalf of the member in additional DSUs. During 2020 the DSU plan was amended to allow Freehold at the time of settlement, at the discretion of the Board of Directors, to pay cash in lieu of issuing common shares on redemption of DSUs. Previously, the DSU plan only allowed for an equity settlement of such units. Freehold's Board of Directors does not currently have a stated intent whether such future settlements of DSUs will be cash or equity-settled but because they have the ability to settle such transactions at their discretion through issuing common shares, this plan will continue to be classified as equity-settled.

During 2020, Freehold granted a total of 66,529 DSUs to members of its Board of Directors as part of their annual compensation resulting in 325,633 outstanding DSUs at December 31, 2020. No shares were granted in exchange for DSUs during 2020 and 2019. Subsequent to December 31, 2020, Freehold's 2021 annual DSU grant to its Board of Directors was issued resulting in 421,104 outstanding DSUs at March 4, 2021.

## Interest and Financing

In 2020, interest and financing expense decreased due to lower average debt levels and interest rates. The average effective interest rate on advances under Freehold's credit facilities during 2020 was 2.5% (2019 - 3.5%). During January 2021, subscription receipt holders (see Subscription Receipts) on record at the close of business on December 31, 2020 received an aggregate dividend equivalent cash payment totaling \$0.3 million reported as an interest and financing charge in 2020.

| (\$000s, except as noted)              | 2020     | 2019     | Change |
|----------------------------------------|----------|----------|--------|
| Interest on long-term debt             | \$ 2,903 | \$ 4,002 | -27%   |
| Dividend equivalent payments           | 252      | -        | 0%     |
| Accretion of decommissioning liability | 110      | 211      | -48%   |
| Accretion of lease obligation          | 37       | 36       | 3%     |
| Other                                  | 71       | -        | 0%     |
| Interest and financing expense         | \$ 3,373 | \$ 4,249 | -21%   |
| Per boe (\$)                           | \$ 0.94  | 1.10     | -15%   |
| Per boe - cash expense (\$)            | \$ 0.90  | 1.03     | -13%   |

## Depletion, Depreciation and Other

Petroleum and natural gas interests, including acquisitions costs, future development costs (if any) and directly attributable general and administrative costs, are depleted on the unit-of-production method based on estimated proved and probable petroleum and natural gas reserves (see Critical Accounting Estimates). Reserves are independently evaluated at year-end. For December 31, 2020, the estimate of proved and probable petroleum and natural gas reserves was based on an external independent qualified reserves evaluator's report effective December 31, 2020. Other recoveries included in depletion, depreciation and other in 2020 totaled \$1.7 million and reflect a gain on disposition (see Working Interest Dispositions) and government assistance for reclamations (see Decommissioning Liability).

| (\$000s, except as noted)         | 2020      | 2019      | Change |
|-----------------------------------|-----------|-----------|--------|
| Depletion, depreciation and other | \$ 79,393 | \$ 94,912 | -16%   |
| Per boe (\$)                      | \$ 22.18  | \$ 24.47  | -9%    |

## Impairment

At December 31, 2020, there were no indicators of impairment on Freehold's United States and Canadian Royalty CGUs, its exploration and evaluation assets or impairment reversal on the Working Interest CGU. As a result, no impairment or impairment reversal testing was conducted.

Freehold tested both the Working Interest and United States and Canadian Royalty CGUs carrying values as at March 31, 2020 for impairment due to that period's decrease in expected future commodity prices resulting from demand destruction caused by the COVID-19 pandemic. Freehold estimated the recoverable amount as the value in use based on discounted future net cash flows of proved and probable petroleum and natural gas reserves and unbooked future development locations using forecasted oil and gas commodity prices and costs for its Royalty and Working Interest CGUs discounted at pre-tax rates of 8% to 10% and 25%, respectively.

These CGUs' value in use estimates as at March 31, 2020 were based on Freehold's December 31, 2019 independently prepared reserve report internally adjusted for forward pricing, production and estimated reserve additions resulting from acquisition activities and an internally prepared estimate of unbooked future development locations. This test identified impairment as charged against the Working Interest CGU as at March 31, 2020 of \$9.6 million as its carrying value exceeded its estimated value in use. This resulted in the estimated recoverable amount of the Working Interest CGU being measured at \$nil.

The following table summarizes forecasted oil and gas commodity price benchmarks at April 1, 2020 used in the determination of recoverable values as at March 31, 2020:

|                                     | WTI      | WCS       | AECO      | Exchange rate |
|-------------------------------------|----------|-----------|-----------|---------------|
|                                     | US\$/bbl | Cdn\$/bbl | Cdn\$/Mcf | Cdn\$/US\$    |
| 2020                                | \$ 29.17 | \$ 19.21  | \$ 1.74   | \$ 0.70       |
| 2021                                | \$ 40.45 | \$ 34.65  | \$ 2.20   | \$ 0.73       |
| 2022                                | \$ 49.17 | \$ 46.34  | \$ 2.38   | \$ 0.75       |
| 2023                                | \$ 53.28 | \$ 51.25  | \$ 2.45   | \$ 0.75       |
| 2024                                | \$ 55.66 | \$ 54.28  | \$ 2.53   | \$ 0.75       |
| 2025                                | \$ 56.87 | \$ 55.72  | \$ 2.60   | \$ 0.75       |
| Average annual increase, thereafter | 2.0%     | 2.0%      | 2.0%      | -             |

During the year ended December 31, 2019, Freehold closed a royalty asset exchange, terminating a production volume royalty (PVR) agreement in exchange for a new gross overriding royalty on certain related properties. Management's best estimate of the new gross overriding royalty's fair value less costs to sell was \$14.1 million lower than the carrying value of the PVR resulting in an equivalent impairment charge for the year ended December 31, 2019. This exchange transaction was not considered an indicator of impairment within Freehold's Canadian Royalty CGU. There were no indicators of impairment as at December 31, 2019.

## Management Fee

The manager (see Related Party Transactions) receives a management fee in Freehold common shares. The management fee was capped at 41,250 Freehold common shares per quarter in 2020 with the fee gradually decreasing to 5,500 shares per quarter by 2023 as per the table below:

|                         | 2020          | 2021   | 2022   | 2023  |
|-------------------------|---------------|--------|--------|-------|
| Quarterly share payment | <b>41,250</b> | 27,500 | 13,750 | 5,500 |

The management fee was down 64% in 2020 compared to 2019 partially due a reduction in capped Freehold common shares but also due to Freehold's share price trading lower during 2020.

|                                             | 2020           | 2019     | Change |
|---------------------------------------------|----------------|----------|--------|
| Shares issued in payment of management fees | <b>165,000</b> | 220,000  | (0.25) |
| Ascribed value (\$000s) <sup>(1)</sup>      | <b>\$ 634</b>  | \$ 1,743 | -64%   |
| Per boe (\$)                                | <b>\$ 0.18</b> | \$ 0.45  | -60%   |

(1) The ascribed value of the management fees is based on the closing share price at the end of each quarter.

## Income Tax

As a corporation, taxable income is based on revenues (which will vary depending on commodity prices and production volumes) less deductible expenses, including tax pool deductions. In 2020, income tax rates for Freehold were approximately 24.8% versus 26.6% in 2019 with both rates reflecting multiple tax jurisdictions. In 2019 and 2020, Freehold's tax pools were lowered to reflect reductions in the Alberta provincial tax rate which reduced to 10% effective January 1, 2020 and then further reduced to 8% on July 1, 2020, respectively.

In 2020 and 2019, Freehold had no current tax expense because it had sufficient tax pool deductions. In 2020, Freehold had a deferred tax recovery of \$3.1 million because its reported expenses exceeded tax deductions. It was the inverse situation in 2019 resulting in a \$3.3 million expense.

## CRA Reassessments

Freehold's corporate income tax filings for 2015, 2018, and 2019 were reassessed by the Canada Revenue Agency (CRA) in 2020 (the Reassessments). Pursuant to the Reassessments, deductions of \$92.6 million of non-capital losses (NCLs) by Freehold were denied, resulting in reassessed taxes, interest, and penalties totaling \$29.3 million, in addition to a denial of \$129.1 million of carried forward NCLs. Freehold has filed its objection of the Reassessments which required deposits totaling \$14.7 million that have been provided to the CRA.

For 2020, Freehold estimates it has sufficient other tax pool deductions to avoid a claim from its NCLs and on this basis it does not expect a reassessment of its 2020 Canadian corporate income tax filing.

Freehold has received legal advice that it should be entitled to deduct the NCLs and as such, management remains of the opinion that all tax filings to date were filed correctly and that it expects to be successful in its objection of these Reassessments and therefore the payment of these deposits held by the CRA should be refunded, plus interest, and the denied NCLs should be reinstated.

## Tax Pools

Freehold is entitled to claim certain tax pool deductions available to all owners of oil and gas properties. Without reflecting the Reassessments, Freehold's tax pools decreased to \$775.4 million at the end 2020 (from \$838.4 million at the end of 2019), as we claimed sufficient tax pool deductions against the \$72.9 million of funds from operations after considering increases to our tax pools caused by 2020 investing activities. The tax pools below are deductible at various jurisdiction tax rates:

| (\$000s)                                                      | 2020       | 2019       | Change |
|---------------------------------------------------------------|------------|------------|--------|
| Canadian oil and gas property expense (10% declining balance) | \$ 598,892 | \$ 661,040 | -9%    |
| Canadian development expense (30% declining balance)          | 15,380     | 21,950     | -30%   |
| Capital cost allowance (generally 25%)                        | 5,454      | 7,727      | -29%   |
| Share issue costs                                             | -          | 1,602      | -100%  |
| Non-capital losses                                            | 134,246    | 129,116    | 4%     |
| Foreign tax pools                                             | 21,440     | 16,984     | 0%     |
| Total                                                         | \$ 775,412 | \$ 838,419 | -8%    |

## Deferred Tax Asset

At December 31, 2020, Freehold had a deferred income tax asset of \$16.3 million (2019 - \$13.1 million) resulting from the combined tax effected differences of tax pools in excess of the associated accounting carrying values.

## Net Income (Loss) and Comprehensive Income (Loss)

In 2020, Freehold's net and comprehensive loss was \$13.9 million versus 2019 net and comprehensive income of \$5.2 million. These decreases were due to lower realized commodity pricing reflecting the weakness in crude oil benchmark pricing and lower production associated with third-party royalty drilling additions only partially offsetting natural declines and increased shut-in production.

| (\$000s, except as noted)         | 2020        | 2019     | Change |
|-----------------------------------|-------------|----------|--------|
| Net income (loss)                 | \$ (13,931) | \$ 5,193 | nm     |
| Per share, basic and diluted (\$) | \$ (0.12)   | \$ 0.04  | nm     |
| Comprehensive income (loss)       | \$ (13,954) | \$ 5,176 | nm     |

nm – not meaningful

## Liquidity and Capital Resources

We define capital (and capitalization) as long-term debt, shareholders' equity and working capital. We manage our capital structure taking into account operating activities, debt levels, debt covenants, acquisitions, dividend levels and taxes, among others. We also consider changes in economic conditions and commodity prices as well as the risk characteristics of our assets. We have a depleting asset base, and ongoing development activities and acquisitions are necessary to replace production and extend reserve life. From time to time, we may issue shares to manage current and projected debt levels or finance acquisitions.

## Operating Activities

### Cash Flow from Operating Activities and Funds from Operations

Funds from operations in 2020 decreased 38% to \$72.9 million from \$118.1 million in 2019 as lower oil prices and reduced production volumes drove the reduction year-over-year. For the same reasons, cash flow from operating activities also decreased 38% to \$65.8 million from \$105.8 million in 2019 despite the reporting year reflecting the payment of a \$14.7 million CRA deposit (see Income Tax).

We consider funds from operations to be a key measure of operating performance as it demonstrates Freehold's ability to generate necessary funds to fund capital expenditures, sustain dividends and repay debt. We believe that such a measure provides a useful assessment of Freehold's operations on a continuing basis by eliminating certain non-cash charges. Funds from operations per share is calculated based on the weighted average number of shares outstanding consistent with the calculation of net income (loss) per share.

| (\$000s, except as noted)         | 2020 |        | 2019       | Change |
|-----------------------------------|------|--------|------------|--------|
| Cash flow from operations         | \$   | 65,767 | \$ 105,801 | -38%   |
| Per share, basic and diluted (\$) | \$   | 0.55   | \$ 0.89    | -38%   |
| Funds from operations             | \$   | 72,891 | \$ 118,098 | -38%   |
| Per share (\$)                    | \$   | 0.61   | \$ 1.00    | -38%   |

## Working Capital

We retain working capital (calculated as current assets less current liabilities) primarily to fund capital expenditures and acquisitions and/or reduce bank indebtedness. In the oil and gas industry, accounts receivable from industry partners are typically settled in the following month. However, due to royalty administration, payments to royalty owners are often delayed longer. Also, working capital can fluctuate significantly due to volume and price changes at each period end, unpaid capital expenditures and asset and liability reclassifications.

Working capital at December 31, 2020 was \$27.2 million, higher by \$12.9 million from year-end 2019. This increase reflects Freehold's payment of an income tax deposit that was required to proceed with its objection to the CRA's Reassessments (see Income Tax) and prepaid subscription receipt issuance and U.S. acquisition costs. Components of working capital include:

| (\$000s)            | As at December 31 |           |        |
|---------------------|-------------------|-----------|--------|
|                     | 2020              | 2019      | Change |
| Current assets      | \$ 95,086         | \$ 26,093 | 264%   |
| Current liabilities | (67,851)          | (11,727)  | 479%   |
| Working capital     | \$ 27,235         | \$ 14,366 | 90%    |

The equity issuance in January 2021 satisfied Freehold's subscription receipt obligation as reported at year-end.

## Decommissioning Liability

Freehold has no decommissioning liability on its royalty interest properties. Freehold's decommissioning liability results from its responsibility to abandon and reclaim its net share of its working interest properties. During 2020, Freehold incurred \$0.5 million on decommissioning expenditures (2019 - \$2.2 million), disposed of working interest properties with associated discounted obligations of \$3.8 million and benefited from \$0.3 million in government incentives.

During 2020, Freehold benefited from a new federal government funded site rehabilitation program administered by the Alberta government. This program allows oil and gas operators to nominate inactive well sites or suspended pipelines across any stage of the abandonment and reclamation process for partial or full government funding. After approval but upon completion of either the abandonment or reclamation work, the provincial government directly pays the service provider at which time Freehold credited depletion, depreciation and other for \$0.3 million as offset through a reduction in the decommissioning liability.

The undiscounted value of Freehold's total decommissioning liability is estimated to be \$6.9 million (2019 – \$10.4 million). Payments to settle the obligations are expected to occur over the next 41 years, with the majority being settled within 10 years. At December 31, 2020, a risk-free rate of 1.2% (2019 – 1.8%) and an inflation rate of 1.5% (2019 – 1.4%) were used to calculate the present value of \$6.9 million (2019 - \$10.4 million).

## Investing Activities

### Acquisitions

Freehold's acquisition strategy targets individual properties or groups of properties to augment our production, reserves and land, with a focus on royalty interests. The key criteria are:

- quality assets;
- attractive returns;
- acceptable risk profile; and
- long economic life.

Freehold spent a total of \$3.3 million (US\$2.4 million) on two closed acquisitions in 2020 for certain royalty assets located in North Dakota.

Subsequent to year-end 2020, Freehold closed three transactions including an acquisition of U.S. royalty properties for US\$58 million (\$74.0 million) before customary adjustments. The acquisition included exposure to approximately 400,000 gross drilling unit acres of mineral title and overriding royalty interest across 12 basins in eight states; predominantly weighted towards the Permian and Eagle Ford basins. 2021 production associated with the acquisition is forecast at 1,250 boe/d.

## Working Interest Dispositions

In 2020, Freehold disposed of certain working interest properties with estimated production of 250 boe/d whereby the purchasers agreed to assume decommissioning liabilities of \$3.8 million associated with these properties in exchange for Freehold paying \$2.4 million.

## Financing Activities

### Long-Term Debt and Net Debt

At 2020 year-end, Freehold had a committed \$165 million secured revolving credit facility with a syndicate of four Canadian chartered banks. In addition, Freehold had available a \$15 million senior secured operating facility. At 2020 year-end \$93 million was drawn on these facilities (2019 - \$109 million).

In May 2019 Freehold amended its credit agreement. The current maturity date of the credit facilities is May 31, 2022 and Freehold may annually request an extension to the maturity date. The credit facilities are not reserve-based but are

secured with \$400 million first charge demand debentures over all of Freehold's assets. The credit agreement contains two financial covenants. The first financial covenant is that long-term debt to EBITDA on royalty interest properties (calculated as earnings on royalty interest properties before non-cash charges including, but not limited to, interest, taxes, depletion and depreciation and amortization) shall not exceed 3.5 times. The actual ratio was 1.2 times at December 31, 2020. The second financial covenant is that the long-term debt to capitalization (the aggregate of long-term debt and shareholders' equity) percentage shall not exceed 55%. The percentage was 12% at 2020 year-end. In addition, Freehold has an affirmative covenant that it must maintain a minimum of 90% of total EBITDA from royalty interest properties over the previous twelve-month period. The actual percentage was 100% at 2020 year-end. Freehold was in compliance with all covenants at 2020 year-end. In addition, Freehold forecasts to be in compliance with all covenants on a quarterly basis for at least the next 12 months based on Freehold's current best estimate of results from operations. As a result of significant uncertainties that exist around the economic impact of COVID-19, actual operating results may vary from Freehold's current best estimate.

Borrowings under the credit facilities bear interest at the bank's prime lending rate, bankers' acceptance or LIBOR rates plus applicable margins and standby fees, dependent on Freehold's long-term debt to EBITDA on royalty interest properties (see Financing and Interest).

At 2020 and 2019 year-ends, the fair values of the long-term debt approximated its carrying values, as the long-term debt carries interest at prevailing market rates. In 2020 net debt decreased by 31% to \$65.8 million at year-end from \$94.6 million at year-end 2019. This reduction was due to funds from operations exceeding acquisition/disposition activities and declared dividends.

Freehold's 2020 net debt to funds from operations ratio was 0.9 times (2019 – 0.8 times) and well within our debt strategy target of below 1.5 times. This ratio is a financial leverage measure that reflects cash available to pay back our debts. It represents the number of years it would take Freehold to reduce its net debt to zero if funds from operations was held constant and there were no other cash outflow obligations required such as dividends and acquisitions, among others. Freehold's long-term debt of \$93 million decreased by 15% year-over-year, primarily due to funds from operations exceeding dividend commitments and acquisition activity. On March 4, 2021, our drawn debt was \$101.5 million, an increase from 2020 year-end reflecting our 2021 acquisitions of U.S. royalty properties.

Freehold defines capital (and capitalization) as net debt plus shareholders' equity. The net debt to capitalization ratio is a financial leverage measure that shows the portion of capital relating to debt. Freehold's ratio in 2020 of 9% (2019 – 12%) reflects its low debt levels and resulting low financial risk.

#### Debt Analysis

| (\$000s)                         | As at December 31 |            |        |
|----------------------------------|-------------------|------------|--------|
|                                  | 2020              | 2019       | Change |
| Long-term debt                   | \$ 93,000         | \$ 109,000 | -15%   |
| Short-term debt (operating line) | -                 | -          | -      |
| Total debt                       | \$ 93,000         | \$ 109,000 | -15%   |
| Working capital                  | (27,235)          | (14,366)   | 90%    |
| Net debt                         | \$ 65,765         | \$ 94,634  | -31%   |

## Financial Leverage Ratios

|                                                    | As at December 31 |      |        |
|----------------------------------------------------|-------------------|------|--------|
|                                                    | 2020              | 2019 | Change |
| Net debt to trailing funds from operations (times) | <b>0.9</b>        | 0.8  | 13%    |
| Net debt to net debt plus shareholders' equity (%) | <b>9</b>          | 12   | -3%    |

## Shareholders' Capital

At December 31, 2020 and March 4, 2021 there were 118,787,667 and 131,435,334 shares outstanding respectively. During 2020, Freehold issued 165,000 shares (2019–220,000) for payment of the management fee (see Related Party Transactions). During 2020 and 2019 there were no shares issued for the redemption of DSUs (see Share Based Compensation).

On December 5, 2020, Freehold issued 12,647,667 subscription receipts at a price of \$4.80 per receipt for gross proceeds of \$60.7 million through a public offering pursuant to Freehold's short form prospectus and a concurrent private placement (see Subscription Receipts). The subscription receipts were exchanged in January 2021 for an equivalent number of Freehold's shares. At year-end, there was the possibility of refunding the subscription receipt proceeds back to the holders, therefore these proceeds, as then held in escrow, were also reported as an obligation at 2020 year-end. Shareholders' capital inclusive of the subscription receipt exchange for an equivalent number of shares net of issuance costs was \$1,331 million.

## Shareholders' Capital

|                                      | December 31, 2020  |                     | December 31, 2019 |                 |
|--------------------------------------|--------------------|---------------------|-------------------|-----------------|
|                                      | Shares             | Amount (\$000s)     | Shares            | Amount (\$000s) |
| Balance, beginning of year           | <b>118,622,667</b> | <b>\$ 1,271,763</b> | 118,402,667       | \$ 1,270,020    |
| Issued for payment of management fee | <b>165,000</b>     | <b>634</b>          | 220,000           | 1,743           |
| Balance, end of year                 | <b>118,787,667</b> | <b>\$ 1,272,397</b> | 118,622,667       | \$ 1,271,763    |

## Shares Outstanding

|                  | As at December 31  |             |
|------------------|--------------------|-------------|
|                  | 2020               | 2019        |
| Weighted average |                    |             |
| Basic            | <b>118,685,218</b> | 118,486,297 |
| Diluted          | <b>118,685,218</b> | 118,713,229 |
| At December 31   | <b>118,787,667</b> | 118,622,667 |

## Dividend Policy and Analysis

The Board reviews and determines the monthly dividend rate on a quarterly basis, or as conditions necessitate, after considering expected commodity prices, foreign exchange rates, economic conditions, production volumes, tax payable, and our capacity to finance operating and investing obligations. The dividend rate is established with the intent of absorbing short-term market volatility over several months. It also recognizes our intention to fund capital expenditures primarily through funds from operations and to maintain a strong balance sheet to take advantage of acquisition opportunities and withstand potential commodity price declines.

The payment of dividends by a corporation is governed by the liquidity and insolvency tests described in the *Business Corporations Act* (Alberta) (ABCA). Pursuant to the ABCA, after the payment of a dividend, we must be able to pay our liabilities as they become due and the realizable value of our assets must be greater than our liabilities and the legal stated capital of our outstanding securities. As at December 31, 2020, our legal stated capital was \$126 million.

#### 2020 Dividends Declared

| Record Date        | Payment Date       | Dividend Amount<br>(\$ per share) |
|--------------------|--------------------|-----------------------------------|
| January 31, 2020   | February 18, 2020  | \$ 0.0525                         |
| February 29, 2020  | March 16, 2020     | 0.0525                            |
| March 31, 2020     | April 15, 2020     | 0.0525                            |
| April 30, 2020     | May 15, 2020       | 0.0150                            |
| May 31, 2020       | June 15, 2020      | 0.0150                            |
| June 30, 2020      | July 15, 2020      | 0.0150                            |
| July 31, 2020      | August 17, 2020    | 0.0150                            |
| August 31, 2020    | September 15, 2020 | 0.0150                            |
| September 30, 2020 | October 15, 2020   | 0.0150                            |
| October 31, 2020   | November 16, 2020  | 0.0150                            |
| November 30, 2020  | December 15, 2020  | 0.0150                            |
| December 31, 2020  | January 15, 2021   | 0.0200                            |
| <b>Total</b>       |                    | <b>\$ 0.2975</b>                  |

Dividends declared in 2020 totaled \$35.3 million (\$0.30 per share), down from \$74.7 million (\$0.63 per share) in 2019. Freehold paid dividends of \$39.2 million (\$0.33 per share) in 2020, also down from \$74.7 million paid in 2019 (\$0.63 per share).

On January 14, 2021, the Board of Directors declared a dividend of \$0.02 per common share or \$2.6 million paid on February 16, 2021 to common shareholders on record on January 31, 2021. On February 11, 2021, the Board of Directors declared a dividend of \$0.02 per common share or \$2.6 million paid on March 15, 2021 to common shareholders on record on February 28, 2021. On March 4, 2021, Freehold's Board of Directors declared a dividend of \$0.03 per common share or \$0.36 per common share annually to be paid on April 15, 2021 to common shareholders on record on March 31, 2021.

From inception in 1996 through to December 31, 2020, Freehold has distributed \$1.7 billion (\$32.60 per share) to our shareholders. Freehold's dividends are designated as eligible dividends for Canadian income tax purposes.

#### Accumulated Dividends <sup>(1)</sup>

|                                         | 2020         | 2019         | Change |
|-----------------------------------------|--------------|--------------|--------|
| Dividends declared (\$000s)             | \$ 35,306    | \$ 74,663    | -53%   |
| Accumulated, beginning of year          | 1,702,543    | 1,627,880    | 5%     |
| Accumulated, end of year                | \$ 1,737,849 | \$ 1,702,543 | 2%     |
| Dividends per share (\$) <sup>(2)</sup> | \$ 0.2975    | \$ 0.6300    | -53%   |
| Accumulated, beginning of year          | 32.3050      | 31.6750      | 2%     |
| Accumulated, end of year                | \$ 32.6025   | \$ 32.3050   | 1%     |

(1) Accumulated dividends reflect distributions paid on trust units of Freehold Royalty Trust (the predecessor of Freehold) from 1996 through 2010 and dividends paid on common shares of Freehold from 2011 onwards.

(2) Based on the number of shares issued and outstanding at each record date.

The following tables reconciles funds from operations to dividends declared. In 2020 Freehold's payout ratio was 54% exhibiting that dividend payments are being made within our means, with excess free cash flow (see Non-GAAP Financial Measures) being used to repay debt and fund acquisitions.

#### Reconciliation of Funds from Operations to Dividends Declared

| (\$000s)                      | 2020      | 2019       | Change |
|-------------------------------|-----------|------------|--------|
| Funds from operations         | \$ 72,891 | \$ 118,098 | -38%   |
| Debt drawing (repayment)      | (16,000)  | 19,000     | nm     |
| Acquisitions                  | (7,058)   | (49,689)   | -86%   |
| Working interest dispositions | (2,338)   | (126)      | 1756%  |
| Working capital change        | (12,189)  | (12,620)   | -3%    |
| Dividends declared            | \$ 35,306 | \$ 74,663  | -53%   |

#### Dividends Analysis

| (\$000s)                            | 2020      | 2019       | Change |
|-------------------------------------|-----------|------------|--------|
| Total dividends paid <sup>(1)</sup> | \$ 39,158 | \$ 74,663  | -48%   |
| Dividends declared                  | \$ 35,306 | \$ 74,663  | -53%   |
| Funds from operations               | \$ 72,891 | \$ 118,098 | -38%   |
| Basic payout ratio <sup>(2)</sup>   | 54%       | 63%        | -9%    |

nm – not meaningful

(1) Based on the dividend payment date which is generally on the 15th day of the month following the month it was declared.

(2) Dividends paid as a percentage of funds from operations (see Non-GAAP Financial Measures).

Payout ratios, which are considered non-GAAP financial measures, are often used for dividend paying companies in the oil and gas industry to identify dividend levels in relation to the funds a company receives and uses in its capital and operational activities. Freehold's payout ratio is calculated as dividends paid as a percentage of funds from operations.

Freehold's payout ratio for 2020 was 54%, below the lower end of our guided dividend payout range of 60%-80% of annualized funds flow, and a decrease versus 63% in 2019. Freehold initially reduced its monthly dividend in Q2-2020, reflecting the COVID-19 pandemic and the significant demand destruction for oil resulting in volatile commodity pricing and uncertainty regarding the timing for recovery. Commodity prices and production volumes on our royalty lands has since improved with funds from operations outperforming expectations. With improved momentum in commodity prices and other macroeconomic factors in North America, Freehold has approved increasing its monthly dividend from \$0.02 to \$0.03 per share or \$0.36 per share on an annualized basis.

## Related Party Transactions

Freehold does not have any employees as Rife Resources Management Ltd. is the manager (the Manager) of Freehold pursuant to an amended and restated management agreement (the Management Agreement). The Manager is a wholly-owned subsidiary of Rife Resources Ltd. (Rife). Rife is 100% owned by the CN Pension Trust Funds (the pension funds for the employees of the Canadian National Railway Company), whereby both Rife and the CN Pension Trust Funds are shareholders of Freehold. Combined they have a 22% ownership in Freehold at December 31, 2020. Canpar Holdings Ltd. (Canpar) is also managed by the Manager and owned 100% by the CN Pension Trust Funds. Two of Rife and Canpar's directors are also directors of Freehold.

All amounts owing to/from the Manager, Rife, and Canpar are unsecured, non-interest bearing and due on demand. All transactions were in the normal course of operations and were measured at the amount of consideration established and agreed to by the parties.

## **Rife Resources Management Ltd.**

The Manager provides certain services for a fee based on a specified number of Freehold common shares issued on a quarterly basis, pursuant to the Management Agreement that capped the management fee at 41,250 shares per quarter for 2020. This resulted in Freehold issuing 165,000 common shares during 2020 versus 220,000 in 2019 as payment of the management fee to the Manager. The respective ascribed values of \$0.6 million and \$1.7 million were based on the closing price of the Freehold's common shares on the last trading day of each quarter. Effective January 1, 2021, the Management Agreement will limit the management fee at 27,500 shares per quarter for 2021.

During 2020 the Manager charged \$11.0 million in general and administrative costs versus \$10.0 million in 2019. At December 31, 2020 and 2019, there was \$0.7 million in accounts payable and accrued liabilities relating to these costs.

## **Rife Resources Ltd. and CN Pension Trust Funds**

During the year ended December 31, 2020, Rife acquired 2,791,667 subscription receipts at \$4.80 per receipt through a private placement that closed concurrently with Freehold's public offering of subscription receipts pursuant to its December 2020 short form prospectus (see Subscription Receipts). No commission was paid in respect of the subscription receipts purchased by Rife pursuant to the private placement. This price per subscription receipt paid by Rife was equivalent to the public offering price. The total proceeds from this private placement were \$13.4 million reflecting a portion of Freehold's reported subscription receipt payable and restricted cash positions at December 31, 2020. During January 2021 and per the same terms as the public offering, upon Freehold's acquisition of U.S. based royalty properties, the private placement subscription receipts were exchanged for an equivalent number of Freehold's common shares.

During 2020, Freehold paid \$1.8 million and \$0.1 million versus \$3.8 million and \$nil in 2019 for dividends and dividend equivalent payments, respectively, to Rife and/or the CN Pension Trust Funds for their combined 22% ownership in Freehold's common shares. The aforementioned no commission private placement also represented 22% of the total issued subscription receipts, and upon exchange on January 5, 2021 for the equivalent number of common shares in Freehold, did not result in a change in the combined ownership percentage of Rife and the CN Pension Trust Funds in Freehold.

In addition, Freehold receives royalties from Rife pursuant to various royalty agreements. For the year ended December 31, 2020, Freehold received royalties of approximately \$0.3 million (2019 – \$0.7 million). At December 31, 2020, there was \$nil (2019 - \$0.1 million) in accounts receivable relating to these transactions. These transactions were measured at the exchange amount of consideration established and agreed upon by both parties.

## **Canpar Holdings Ltd.**

Freehold and Canpar share mineral title ownership in a substantial land base in western Canada. Generally, Canpar owns mineral rights that were below the deepest producing formation at the time that Freehold was created, and Freehold holds the balance of the mineral rights. Where Freehold is not the legal registered owner of such mineral rights, Canpar holds these rights in trust for Freehold and receives the royalty payments in respect of such mineral rights on behalf of

Freehold. At December 31, 2020 and 2019, there was \$nil (2019 - \$nil) in accounts receivable and accounts payable and accrued liabilities relating to transactions with Canpar.

## Key Management Personnel Compensation

Expenses relating to compensation for key management personnel, considered to be the members of the Board and executive officers, are as follows:

| (\$000s)                           | 2020            | 2019            |
|------------------------------------|-----------------|-----------------|
| Salaries, fees and benefits        | \$ 1,971        | \$ 1,803        |
| Share-based compensation           | 761             | 899             |
| <b>Key management compensation</b> | <b>\$ 2,732</b> | <b>\$ 2,702</b> |

In December 2020, the Board of Directors approved an amendment to the DSU plan to permit each non-management Board member to elect on an annual basis to receive the equivalent fair value of DSUs in lieu of all or a portion of his or her annual remuneration.

## Select Annual Information

|                                            | 2020        | 2019       | 2018       |
|--------------------------------------------|-------------|------------|------------|
| <b>Financial (\$000s, except as noted)</b> |             |            |            |
| Royalty and other revenue                  | \$ 89,958   | \$ 140,837 | \$ 144,542 |
| Net income (loss)                          | \$ (13,931) | \$ 5,193   | \$ 14,032  |
| Per share, basic and diluted (\$)          | \$ (0.12)   | \$ 0.04    | \$ 0.12    |
| Dividends declared                         | \$ 35,306   | \$ 74,663  | \$ 73,928  |
| Per share (\$) <sup>(1)</sup>              | \$ 0.2975   | \$ 0.6300  | \$ 0.6250  |
| Total assets (\$)                          | \$ 829,909  | \$ 839,893 | \$ 888,299 |
| Long term debt                             | \$ 93,000   | \$ 109,000 | \$ 90,000  |

(1) Based on the number of shares issued and outstanding at each record date.

## Select Quarterly Information

|                                                    | 2020    |         |         |         | 2019    |         |         |         |
|----------------------------------------------------|---------|---------|---------|---------|---------|---------|---------|---------|
|                                                    | Q4      | Q3      | Q2      | Q1      | Q4      | Q3      | Q2      | Q1      |
| <b>Financial</b> (\$'000s, except as noted)        |         |         |         |         |         |         |         |         |
| Royalty and other revenue                          | 25,793  | 23,123  | 14,758  | 26,284  | 36,827  | 33,068  | 35,333  | 35,609  |
| Funds from operations                              | 22,129  | 19,893  | 10,622  | 20,248  | 30,659  | 27,996  | 30,095  | 29,348  |
| Per share, basic (\$)                              | 0.19    | 0.17    | 0.09    | 0.17    | 0.26    | 0.24    | 0.25    | 0.25    |
| Net income (loss)                                  | 373     | 139     | (5,421) | (9,022) | 6,113   | 2,729   | 3,430   | (7,079) |
| Per share, basic and diluted (\$)                  | -       | -       | (0.05)  | (0.08)  | 0.05    | 0.02    | 0.03    | (0.06)  |
| Dividends declared                                 | 5,938   | 5,342   | 5,341   | 18,685  | 18,683  | 18,669  | 18,660  | 18,651  |
| Per share (\$) <sup>(1)</sup>                      | 0.0500  | 0.0450  | 0.0450  | 0.1575  | 0.1575  | 0.1575  | 0.1575  | 0.1575  |
| Payout ratio (%) <sup>(2)</sup>                    | 24      | 27      | 92      | 92      | 61      | 67      | 62      | 64      |
| Operating Income <sup>(2)</sup>                    | 25,509  | 22,877  | 14,244  | 25,296  | 35,758  | 32,175  | 34,315  | 34,644  |
| Operating income from royalties (%)                | 99      | 100     | 103     | 100     | 100     | 100     | 100     | 99      |
| Acquisitions and related expenditures              | 222     | 485     | 981     | 5,370   | 2,727   | 15,060  | 30,313  | 929     |
| Working interest dispositions paid (received)      | (36)    | 7       | 2,294   | (73)    | 36      | 8       | 52      | (30)    |
| Long term debt                                     | 93,000  | 107,000 | 102,000 | 103,000 | 109,000 | 116,000 | 111,000 | 90,000  |
| <b>Shares outstanding</b>                          |         |         |         |         |         |         |         |         |
| Weighted average, basic (000s)                     | 118,747 | 118,706 | 118,664 | 118,623 | 118,568 | 118,513 | 118,458 | 118,403 |
| At quarter end (000s)                              | 118,788 | 118,746 | 118,705 | 118,664 | 118,623 | 118,568 | 118,513 | 118,458 |
| <b>Operating</b> (\$/boe, except as noted)         |         |         |         |         |         |         |         |         |
| Royalty production (boe/d) <sup>(3)</sup>          | 9,563   | 9,096   | 9,150   | 10,618  | 10,315  | 10,149  | 10,311  | 10,139  |
| Light and medium oil (bbls/d)                      | 3,239   | 3,383   | 3,313   | 3,863   | 4,024   | 3,771   | 3,727   | 3,734   |
| Heavy oil (bbls/d)                                 | 1,173   | 791     | 872     | 1,238   | 1,089   | 1,148   | 983     | 911     |
| NGL (bbls/d)                                       | 813     | 848     | 772     | 872     | 799     | 740     | 962     | 912     |
| Total liquids (bbls/d)                             | 5,225   | 5,022   | 4,957   | 5,973   | 5,912   | 5,659   | 5,672   | 5,557   |
| Natural gas (Mcf/d)                                | 26,027  | 24,446  | 25,156  | 27,870  | 26,416  | 26,938  | 27,834  | 27,492  |
| Total production (boe/d) <sup>(3)</sup>            | 9,681   | 9,143   | 9,285   | 11,026  | 10,740  | 10,482  | 10,664  | 10,627  |
| Royalty interest (%)                               | 99      | 99      | 99      | 96      | 96      | 97      | 97      | 95      |
| Average selling price                              | 28.16   | 26.93   | 17.08   | 25.69   | 37.04   | 33.87   | 35.88   | 36.29   |
| Operating netback <sup>(2)</sup>                   | 28.64   | 27.20   | 16.86   | 25.22   | 36.19   | 33.36   | 35.36   | 36.22   |
| Operating expenses                                 | 0.32    | 0.29    | 0.61    | 0.98    | 1.08    | 0.93    | 1.05    | 1.01    |
| General and administrative expenses <sup>(4)</sup> | 2.74    | 2.71    | 2.92    | 3.73    | 2.97    | 2.59    | 2.67    | 4.22    |
| <b>Benchmark Prices</b>                            |         |         |         |         |         |         |         |         |
| West Texas Intermediate crude oil (US\$/bbl)       | 42.47   | 40.91   | 27.81   | 45.65   | 56.99   | 56.36   | 59.79   | 54.82   |
| Exchange rate (Cdn\$/US\$)                         | 0.77    | 0.75    | 0.72    | 0.74    | 0.76    | 0.76    | 0.75    | 0.75    |
| Edmonton Light Sweet crude oil (Cdn\$/bbl)         | 50.45   | 49.81   | 29.79   | 51.77   | 68.12   | 70.27   | 73.84   | 66.02   |
| Western Canadian Select crude oil (Cdn\$/bbl)      | 43.56   | 42.55   | 22.37   | 34.02   | 54.16   | 58.12   | 65.66   | 56.77   |
| AECO monthly contract natural gas (Cdn\$/Mcf)      | 2.76    | 2.14    | 1.85    | 2.13    | 2.34    | 1.04    | 1.17    | 1.94    |

- (1) Based on the number of shares issued and outstanding at each record date.  
(2) See Non-GAAP Financial Measures.  
(3) Reported production for a period may include adjustments from previous production periods.  
(4) Excludes share based compensation.

# Business Risks and Mitigating Strategies

Our operations are subject to some of the same industry risks and conditions faced by oil and gas companies. The most significant of these include the following:

- fluctuations in commodity prices and quality differentials as a result of weather patterns, world and North American market forces or shifts in the balance between supply and demand for crude oil and gas;
- the impact of the COVID-19 pandemic on demand and commodity prices;
- climate change and ESG concerns reducing the demand for crude oil and gas;
- access to pipelines or other transportation methods for bringing oil and natural gas to market;
- variations in currency exchange rates;
- imprecision of reserve estimates and uncertainty of depletion and recoverability of reserves. Our reserves will deplete over time through continued production and we and our industry partners and royalty payors may not be able to replace these reserves on an economic basis;
- reliance on royalty payors to drill and produce on our lands and their ability to pay their obligations;
- industry activity levels and intense competition for land, goods and services, and qualified personnel;
- stock market volatility and the ability to access sufficient capital from internal and external sources;
- risk associated with volatility in global financial markets;
- risk associated with the renegotiation of our credit facility;
- operational or marketing risks resulting in delivery interruptions, delays or unanticipated production declines;
- changes in government regulations, taxation, and royalties; and
- safety and environmental risks.

For a more detailed description of risk factors, please see our Annual Information Form, filed on SEDAR.

We employ the following strategies to mitigate these risks:

- Our diversified revenue stream limits the size of any one property with respect to our total assets.
- We are not liable for abandonment and reclamation costs on our royalty lands.
- Due to our high percentage of royalty lands, we have one of the lowest all-in cost structures of our peer group. In addition, we maintain a focus on controlling direct costs to maximize profitability.
- We negotiate agreements that provide mechanisms to ensure that our interests are protected.
- Systems and processes are in place to identify any unpaid or incorrect revenues.
- We maintain a dedicated compliance function, with a comprehensive auditing program, to ensure that the terms of the various agreements are followed. During 2020, our audit staff issued audit exception queries amounting to \$2.3 million, bringing the total amount of audit exception queries since 1997 to \$97.9 million, of which we have successfully recovered \$79.0 million.
- We adhere to strict investment criteria for acquisitions, seeking quality royalty properties that have attractive returns, acceptable risk profiles and long economic lives.
- We market our products to a diverse range of buyers or with our diverse range of royalty payors. Currently, we do not have any commodity price, exchange rate, or interest rate hedging programs in place.
- We employ a qualified Manager that has many years of experience and knowledge in managing our assets.

- We maintain levels of liability insurance that meet or exceed industry standards.
- We employ a conservative approach to debt management. As circumstances warrant, we allocate a portion of funds from operations to debt repayment.
- Strong balance sheet – focus on acquisitions with economics with strong characteristics – ESG friendly business model – low carbon footprint.

## Environmental Regulation and Risk

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. 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.

Climate change and ESG policies are 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. Climate change concerns globally may also impact the demand for crude oil and gas. Additional specific risk factors related to the environment and climate change are included in Freehold's Annual Information Form.

## Controls and Accounting Matters

In compliance with National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings* (NI 52-109), Freehold has filed certificates signed by our Chief Executive Officer (CEO) and Chief Financial Officer (CFO) that, among other things, deal with the matter of disclosure controls and procedures and internal control over financial reporting. While we believe that our disclosure controls and procedures and internal control over financial reporting provide a reasonable level of assurance, we do not expect that the controls will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objective of the control system is met.

## Disclosure Controls

As of December 31, 2020, an internal evaluation was carried out of the effectiveness of Freehold's disclosure controls and procedures. This evaluation was performed under the supervision of, and with the participation of the CEO and the CFO. It took into consideration Freehold's Disclosure, Insider Trading, Code of Business Conduct and Conflict of Interest, and Whistleblower policies, as well as the functioning of the Manager, the officers, the Board and Board Committees. In addition, the evaluation covered the processes, systems and capabilities relating to regulatory filings, public disclosures, and the identification and communication of material information. Based on this evaluation, management has concluded that Freehold's disclosure controls and procedures were effective as at December 31, 2020, in ensuring that material information is made known to management in a timely manner, particularly during the period in which the annual filings were being prepared, and information required to be disclosed by Freehold in its annual filings, interim

filings or other reports filed or submitted by Freehold under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation.

## Internal Control Over Financial Reporting

Our CEO and CFO are responsible for establishing and maintaining internal control over financial reporting (ICFR). They have caused ICFR to be designed under their supervision to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with Canadian GAAP. The control framework used to design ICFR is the Internal Control – Integrated Framework (2013 COSO Framework) published by The Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Under the supervision of the CEO and CFO, Freehold conducted an evaluation of the effectiveness of its ICFR as at December 31, 2020, as structured within the 2013 COSO Framework. Based on this evaluation, the CEO and CFO concluded that, as of December 31, 2020, that ICFR was effective. Our ICFR provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. There were no changes in our ICFR during the period beginning on October 1, 2020 and ended on December 31, 2020 that materially affected Freehold's ICFR.

## New Accounting Standard Amendments

On January 1, 2020, Freehold adopted the amendments to the definition of a business in IFRS 3 Business Combinations. The amendments are intended to provide additional guidance to determine if a transaction should be recorded as a business combination or an asset acquisition. 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 if an acquired process is substantive, narrow the definitions of a business and of outputs, and introduce an optional fair value concentration test. This standard was applied prospectively. No business combinations were completed for the year ended December 31, 2020.

## Use of Estimates and Judgment

The preparation of financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses during the reporting period. Actual results could differ as a result of using estimates.

## Petroleum and Natural Gas Reserves

The amounts recorded for the depletion of petroleum and natural gas interests, the provision for decommissioning liability, business combinations, indicators of impairment or impairment reversal and the amounts used in an impairment calculation are based on estimates of proved and probable petroleum and natural gas reserves. By their nature, these estimates of proved and probable petroleum and natural gas reserves and the related cash flows are subject to uncertainty including significant assumptions related to forecasted royalty production from proved and probable petroleum and natural gas reserves and forecasted oil and gas commodity prices and the impact on the financial statements of future periods could be material. Freehold's proved and probable petroleum and natural gas reserves have been prepared at December 31, 2020 by the Company's external independent qualified reserves evaluator. Significant management judgment is required to analyze internal and external indicators of impairment for

petroleum and natural gas interests and exploration and evaluation assets with the estimate of proved and probable petroleum and natural gas reserves and the related cash flows being significant to the assessment.

## **Unbooked future development locations**

Unbooked future development locations on royalty lands and the associated future cash flows can also be used in an impairment calculation. These unbooked future development locations are determined from a historical analysis of booking previously undeveloped reserves into the independently prepared reserve report. By their nature, this estimate and future cash flows are subject to uncertainty including significant assumptions related to future royalty production and forecasted oil and gas commodity prices and timing of third-party development.

## **Decommissioning liability**

The decommissioning liability amounts recorded are based on estimates of inflation rates, risk-free rates, timing of abandonments and future abandonment and reclamation costs, all of which are subject to uncertainty.

## **Share-based compensation**

The recorded amounts for share-based compensation include an estimate of forfeitures and certain management assumptions. Actual results could differ as a result of using an estimate and assumptions.

## **Income taxes**

Deferred income tax liabilities and assets are recognized for the estimated tax consequences attributable to differences between the amounts reported in the financial statements and their respective tax bases, using enacted or substantively enacted income tax rates. The effect of a change in income tax rates on deferred income tax liabilities and assets is recognized in income in the period that the change occurs. The actual amount of income tax may be greater than or less than the estimates and the differences may be material. Management reviews the adequacy of these amounts at the end of the reporting period. However, it is possible that at some future date there is a change in the income tax liability or asset resulting from audits by taxing authorities. Where the probable outcome of these tax related matters is different from the amounts that were initially recorded, such differences will affect the income tax provisions in the period in which such determination is made.

## **Cash generating units**

The determination of a cash generating unit (CGU) is subject to management judgment. The recoverability of petroleum and natural gas interests and exploration and evaluation assets are assessed at the CGU level. A CGU is the lowest level at which there are identifiable cash inflows that are largely independent of the cash inflows of other CGUs.

## **Business combination**

Each acquisition transaction is reviewed by management and judgment is used when determining if the transaction met the IFRS 3 inputs and processes criteria for business combinations.

## **Petroleum and natural gas royalty revenue accruals**

Freehold follows the accrual method of accounting, making estimates in its financial and operating results. This may include estimates of revenues, which are based on significant assumptions related to royalty production and realized

commodity pricing for the period being reported, for which actual results have not yet been received. It is expected that these accrual estimates will be revised, upwards or downwards, based on the receipt of actual results. Freehold has no operational control over its royalty lands and primarily holds small interests in several thousand wells. Thus, obtaining timely production data from the well operators is extremely difficult. As a result, the Company uses both historical production information, new wells on stream and publicly available production data pursuant to the terms of the Company's leases and royalty agreements to determine royalty production. Realized commodity prices are based on publicly available price benchmarks, adjusted for quality, location, allowable deductions, or other factors pursuant to the terms of the Company's leases and royalty agreements. These royalty revenue accrual estimates are revised based on actual royalty production volumes and realized commodity prices received in subsequent periods. The royalty revenue accrual is necessary due to the delay between the timing of oil and gas production and when the Company receives its royalty production and payment, which is typically a time lag of approximately two to three months.

Judgment is required to determine the interests of royalty properties in areas where mineral rights are shared with a related party, Canpar Holdings Ltd. (Canpar). Freehold uses publicly available information on geological formations to apportion revenues between the entities in accordance with the respective party's interests. As new geological information becomes available and as part of its ongoing internal audit activities, Freehold periodically revises these allocations and consideration is transferred to reflect the changes.

## Significant Accounting Policies

The most significant of Freehold's accounting policies are as follows:

### Exploration and evaluation assets

Exploration and evaluation (E&E) costs are accounted for in accordance with IFRS 6, Exploration for and Evaluation of Mineral Resources. All E&E costs incurred after acquiring the "right to explore" are capitalized into a single cost pool. Upon determination of the technical feasibility and commercial viability of reserves, the associated E&E costs are first assessed for impairment and then the estimated recoverable amount is transferred to petroleum and natural gas interests. All costs incurred prior to acquiring the "right to explore" are expensed as incurred. At each reporting date, E&E costs are reviewed for indicators of impairment using internal and external market and industry data. If circumstances indicate the carrying amount exceeds its recoverable amount, the cost is written down to its recoverable amount and the difference is accounted for as an impairment expense. No depletion or depreciation is charged to E&E.

### Impairment and impairment reversals

The Company assesses at each reporting date whether there is an indication that any CGU within petroleum and natural gas interests may be impaired. Significant management judgment is required to analyze internal and external indicators of impairment with the estimate of proved and probable petroleum and natural gas reserves. In some instances, there is also the potential for inclusion of unbooked future development locations on royalty lands and the related cash flows being significant to the assessment. If any such indication of impairment exists, Freehold makes an estimate of its recoverable amount. A CGU's recoverable amount is the higher of its fair value less costs of disposal (FVLCTD) and its value in use (VIU). Where the carrying amount of a CGU exceeds its recoverable amount, the CGU is considered impaired and is written down. In assessing VIU, the estimated future cash flows are adjusted for the risks specific to the CGU and are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money. FVLCTD is the amount obtainable from the sale of assets in an arm's length transaction less cost of disposal.

An assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or have decreased. If such indication exists, the recoverable amount is estimated. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the CGU's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the CGU is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depletion, had no impairment loss been recognized for the CGU in prior periods. Such a reversal is recognized in profit or loss. After such a reversal, the depletion charge is adjusted in future periods to allocate the CGU's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

## Revenue recognition

Royalty and other revenue is made up of royalty, working interest and other revenue earned during the period. The vast majority of royalty and other revenue represents the sale of crude oil, natural gas, natural gas liquids and other products. It was determined that Freehold has two different types of revenue streams coming from the sale of these products: royalty revenue and working interest revenue. The Company earns royalty revenue from the sale of crude oil, natural gas, natural gas liquids and other products that is recognized as it accrues in accordance with the terms of the leases and royalty agreements, which is generally in the month when the oil and gas is produced. The royalty revenue accrual is necessary due to the delay between the timing of oil and gas production and when the Company receives its royalty production and payment, which is typically a time lag of approximately two to three months.

Royalty and other revenue also includes bonus consideration and lease rentals which have different performance obligations. When a new mineral lease is executed, Freehold gives the third-party exclusive access to specifically identified lands for a certain time period and typically receives a lump sum non-refundable payment (bonus consideration). As the payment is non-refundable and access to land is granted, the performance obligation is met, and revenue is recognized when the lease is executed. Lease rental revenue is recognized annually on the anniversary date of the lease execution when the payment is due and received.

Royalty and other revenue is measured at fair value of the consideration received or receivable per the terms of the various agreements. Freehold estimates royalty production based on historical production information, new wells on stream and publicly available production data and estimates realized commodity prices based on publicly available price benchmarks, adjusted for quality, location, allowable deductions, or other factors pursuant to the terms of the Company's leases and royalty agreements. Actual results could differ as a result of using estimates and any differences are recorded in the period in which actuals are received.

## Forward-Looking Statements

Certain statements contained in this MD&A constitute forward-looking statements. These statements relate to future events or our expectations of future performance. All statements other than statements of historical fact may be forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "plan", "continue", "estimate", "expect", "may", "will", "forecast", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar expressions (including the negatives thereof). These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements. We believe the expectations reflected in those forward-looking statements are reasonable but no assurance can be given that these

expectations will prove to be correct and, as such, forward-looking statements included in this MD&A should not be unduly relied upon. These forward-looking statements are provided to allow readers to better understand our business and prospects.

In particular, this MD&A contains forward-looking statements under the headings Freehold's Strategy, Outlook, 2021 Guidance, Subsequent Events, Operating and Financial Highlights, Drilling Activity, CRA Reassessments and Liquidity and Capital Resources pertaining to the following:

- our expectation of generating lower risk returns to our shareholders by driving oil and gas development on our lands through our lease program, acquiring royalty assets with acceptable risk profiles and long economic life and generating gross overriding royalties for revenue growth.;
- our intent to maintain balance sheet strength (1.5 times or less net debt to funds from operations) and achieve a payout ratio of between 60%-80%;
- our outlook for commodity prices including supply and demand factors relating to crude oil, heavy oil and natural gas;
- light/heavy oil price differentials;
- forecast of additional wells drilled in 2021;
- 2021 guidance including average royalty production (including commodity weighting) and commodity prices;
- our expectation of seeing meaningful, high quality, acquisition opportunities across North America;
- our expectation of strong third-party drilling and production additions within our Canadian and U.S. portfolios in 2021;
- our expectation that the acquisition of U.S royalty production and royalty lands will further diversify our royalty lands, bringing added sustainability to our portfolio and dividend;
- our expectation that we will be successful in our objection of the Reassessments and the payment of the deposits held by the CRA will be refunded, plus interest, and the denied NCLs will be reinstated;
- 2021 forecast production associated with our U.S. royalty asset acquisition that closed in 2021;
- our forecast to be in compliance with all covenants under our credit facilities on a quarterly basis for at least the next 12 months based on Freehold's current best estimate of results from operations;
- our dividend policy and expectations for future dividends; and
- treatment under governmental regulatory regimes and tax laws.

Our actual results could differ materially from those anticipated in these forward-looking statements because of many factors, the most significant of which are as follows:

- volatility in market prices for crude oil, NGL and natural gas;
- the continuing impact of the COVID-19 pandemic on demand and commodity prices;
- future capital expenditure levels;
- future production levels;
- future exchange rates;
- future tax rates;
- future legislation;
- the cost of developing and expanding our assets;
- our ability and the ability of our industry partners and royalty payors to obtain equipment in a timely manner to carry out development activities;

- our ability to market our product successfully to current and new customers;
- our expectation for the consumption of crude oil, NGL and natural gas;
- our expectation for industry drilling levels on our royalty lands;
- the impact of competition;
- our ability to obtain financing on acceptable terms;
- our ability to add production and reserves through our development and acquisitions activities.
- lack of pipeline capacity;
- currency fluctuations;
- changes in income tax laws or changes in tax laws, regulations, royalties, or incentive programs relating to the oil and gas industry;
- reliance on royalty payors to drill and produce on our lands and their ability to pay their obligations;
- uncertainties or imprecision associated with estimating oil and gas reserves;
- stock market volatility and our ability to access sufficient capital from internal and external sources;
- a significant or prolonged downturn in general economic conditions or industry activity;
- incorrect assessments of the value of acquisitions;
- competition for, among other things, capital, acquisitions of reserves, undeveloped lands and skilled personnel;
- geological, technical, drilling, and processing problems;
- environmental risks and liabilities inherent in oil and gas operations; and
- other factors discussed in Freehold's annual MD&A and audited financial statements for the year-ended December 31, 2020 and our Annual Information Form.

Key operating assumptions with respect to the forward-looking statements contained in this MD&A are provided in the Outlook section and elsewhere in this MD&A. In addition, with respect to forward-looking statements contained in this MD&A, we have made assumptions regarding, among other things, future commodity prices, future capital expenditure levels, future production levels, future exchange rates, future tax rates, future legislation, the cost of developing and producing our assets, our ability and the ability of our lessees to obtain equipment in a timely manner to carry out development activities, our ability to market our oil and gas successfully to current and new customers, our expectation for the consumption of crude oil and natural gas, our expectation for industry drilling levels, our ability to obtain financing on acceptable terms, shut-in production, production additions from our audit function and our ability to add production and reserves through development and acquisition activities and elsewhere in this MD&A.

To the extent any guidance or forward-looking statements herein constitutes a financial outlook, they are included herein to provide readers with an understanding of management's plans and assumptions for budgeting purposes and readers are cautioned that the information may not be appropriate for other purposes. You are further cautioned that the preparation of 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 income, as further information becomes available and as the economic environment changes.

The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement and speak only as of the date of this MD&A. Our policy for updating forward-looking statements is to update our key operating

assumptions quarterly and, except as required by law, we do not undertake to update any other forward-looking statements.

## Non-GAAP Financial Measures

Within this MD&A, references are made to terms commonly used as key performance indicators in the oil and gas industry. We believe that operating income, operating netback, payout ratio, free cash flow and cash costs are useful supplemental measures for management and investors to analyze operating performance, financial leverage, and liquidity, and we use these terms to facilitate the understanding and comparability of our results of operations and financial position. However, these terms do not have any standardized meanings prescribed by GAAP and therefore may not be comparable with the calculations of similar measures for other entities.

Operating income is calculated as royalty and other revenue less royalty and operating expenses. It shows the profitability of our revenue streams as it provides the cash margin for product sold after directly related expenses. Operating netback, which is calculated as average unit sales price less royalty and operating expenses, represents the cash margin for product sold, calculated on a per boe basis (see our Netback Analysis section for calculations).

Payout ratios are often used for dividend paying companies in the oil and gas industry to identify its dividend levels in relation to the funds it receives and uses in its capital and operational activities. Payout ratio is calculated as dividends declared as a percentage of funds from operations.

Free cash flow is calculated by subtracting capital expenditures from funds from operations. In periods where Freehold has no capital expenditures, this figure is interchangeable with funds from operations. Free cash flow is a measure often used by dividend paying companies to determine cash available for the payment of dividends, reducing debt or available for investment.

Cash costs is a total of all recurring costs in the statement of income deducted in determining funds from operations. For Freehold cash costs are identified as operating expense, G&A expense, interest expense and share based compensation payments. It is key to funds from operations, representing the ability to sustain dividends, repay debt and fund capital expenditures.

| (\$000s)                                 | 2020      | 2019      | Change |
|------------------------------------------|-----------|-----------|--------|
| Operating expense                        | \$ 2,032  | \$ 3,945  | -48%   |
| General and administrative expenses      | 10,930    | 12,063    | -9%    |
| Interest and financing expense           | 3,226     | 4,002     | -19%   |
| Expenditures on share based compensation | 389       | 544       | -28%   |
| Total cash costs                         | \$ 16,577 | \$ 20,554 | -19%   |
| Per boe (\$)                             | \$ 4.63   | \$ 5.30   | -13%   |

We refer to various per boe figures which provide meaningful information on our operational performance. We derive per boe figures by dividing the relevant revenue or cost figures by the total volume of oil, NGL and natural gas production during the period, with natural gas converted to equivalent barrels of oil as described above.

## Conversion of Natural Gas to Barrels of Oil Equivalent (boe)

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 barrel). 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, 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.