MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE YEAR ENDED DECEMBER 31, 2018

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MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is Management's Discussion and Analysis ("MD&A") dated March 14, 2019 of the operating and financial results of Source Energy Services Ltd. and its subsidiaries, collectively ("Source" or, the "Company") as at and for the three months and year ended December 31, 2018 compared with the corresponding periods in the prior year. The MD&A is provided to assist readers in understanding the Company's financial performance and position during the periods presented and significant trends that may impact the future performance of Source.

This discussion should be read in conjunction with Source's audited consolidated financial statements for the years ended December 31, 2018 and 2017, together with the accompanying notes (the "Financial Statements"). The Financial Statements and other information relating to Source, including the Annual Information Form ("AIF"), are available under the Company's SEDAR profile at www.sedar.com. The Financial Statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). Unless otherwise stated, all amounts are expressed in Canadian dollars.

Certain financial measures referred to in this MD&A are not prescribed by IFRS. "EBITDA" and "Adjusted EBITDA" are used by management as a representation of earnings generated to fund capital investments and meet financial obligations and "Adjusted Gross Margin" is used by management to assist in comparisons with peers. See "Non-IFRS Measures" for further information regarding the following non-IFRS measures used in this MD&A: "EBITDA", "Adjusted EBITDA", "Adjusted Gross Margin" and "Free Cash Flow". These non-IFRS measures are reconciled to IFRS measures in the "Non-IFRS Measures" section in this MD&A.

This MD&A contains "forward-looking statements" or "forward-looking information" within the meaning of applicable Canadian securities laws (collectively, "forward-looking statements") based on Source's current expectations and projections. For information on the material factors and assumptions underlying such forward-looking statements, refer to "Forward-Looking Statements" included at the end of this MD&A.

About Source

Source is a fully integrated producer, supplier and distributer of high quality Northern White frac sand. Source provides its customers with a full end-to-end solution supported by its Wisconsin mines and processing facilities, its Western Canadian terminal network and its "last mile" logistics capabilities. In addition to its industry leading frac sand transload terminal network and in-basin frac sand storage capabilities, Source also provides storage and logistics services for other bulk oil and gas well completion materials that aren't produced by Source. Source has also developed Sahara, a proprietary wellsite mobile sand storage and handling system.

Source's full-service approach allows customers to rely on its logistics capabilities to increase reliability of supply and to ensure the timely delivery of their requirements for frac sand and other bulk completion materials at the wellsite.

2018 Highlights

Source achieved the following results for the year ended December 31, 2018:

- Recorded Adjusted EBITDA[(1)] of $59.0 million, an improvement of 35% year-over-year;
- Achieved record sand volumes of 2,560,855 MT and sand revenue of $342.4 million, an increase of 35% and 50%, respectively, year-over-year;
- Reduced Net Loss by $6.1 million, or 68%, year-over-year;
- Realized a Gross Margin of $69.0 million and Adjusted Gross Margin[(1)] of $89.3 million;
- Delivered 90% of 2018 Source sand sales volumes into the Western Canadian Sedimentary Basin (the "WCSB"), an increase of 4% year-over-year;
- Entered into multi year agreements with Shell Canada Energy and another multinational party to support development of their Duvernay projects;
- Entered into a three-year agreement with Strath Resources Ltd. to provide Northern White proppant for Strath's Montney wells;
- Deployed three more Sahara units to the existing fleet of three, with one being deployed into the US. Two additional Sahara units under construction;
- Opened the unit-train-capable Fox Creek terminal and finished expansion of the dual-unit-train-capable Wembley terminal;
- Successfully increased liquidity through the issuance of an additional $50.0 million of 10.5% senior secured first lien notes due December 15, 2021 (the "Notes") combined with an increase of the Credit Facility (as defined below) from $70.0 million to $88.0 million; and
- Completed production facility expansions and improvements at the Preston and Blair facilities that enable Source to continue to grow its business without significant additional capital.

Note:

(1) Adjusted EBITDA and Adjusted Gross Margin (including on a per MT basis) are not defined under IFRS, see "Non-IFRS Measures" below.

Results Overview

($000's, except MT and per unit amounts)	Three months ended December 31 2018	2017	Year ended December 31 2018	2017
Sand Volumes (MT)[1]	**373,171**	557,363	**2,560,855**	1,902,106
Sand Revenue	**45,459**	63,986	**342,428**	228,403
Wellsite Solutions	**7,299**	10,308	**67,264**	54,911
Terminal Services	**1,307**	894	**5,335**	6,184
Sales	**54,065**	75,188	**415,027**	289,498
Cost of Sales	**47,109**	57,572	**325,738**	225,927
Cost of Sales – Depreciation and Depletion	**3,253**	3,998	**20,274**	11,948
Cost of Sales	**50,362**	61,570	**346,012**	237,875
Gross Margin	**3,703**	13,618	**69,015**	51,623
Operating and General and Administrative Expenses	**10,455**	8,227	**33,323**	24,509
Depreciation	**3,083**	2,081	**12,009**	6,560
Income (Loss) from operations	**(9,835)**	3,310	**23,683**	20,554
Other expense(income):				
Loss (gain) on asset disposal	**(347)**	(3)	**4,640**	(6)
Finance expense	**5,956**	5,575	**20,961**	28,342
Loss (gain) on derivative liability	**368**	1,316	**(1,503)**	(1,581)
Share based compensation expense	**(372)**	1,770	**2,403**	6,625
Other income	**(142)**	(144)	**(532)**	(1,266)
Management fees	**—**	—	**—**	417
Foreign exchange loss (gain)[2]	**(127)**	(1,971)	**(590)**	(863)
Total other expense	**5,336**	6,543	**25,379**	31,668
Income (loss) before income taxes	**(15,171)**	(3,233)	**(1,696)**	(11,114)
Current income tax expense (recovery)	**—**	(5,268)	**—**	—
Deferred income tax expense (recovery)	**(366)**	3,137	**1,169**	(2,179)
Net Income (Loss)	**(14,805)**	(1,102)	**(2,865)**	(8,935)
Net Income (Loss) per share ($/share)	**(0.22)**	(0.02)	**(0.04)**	(0.19)
Diluted Net Income (Loss) per share ($/share)	**(0.22)**	(0.02)	**(0.04)**	(0.19)
Adjusted EBITDA[3]	**(3,230)**	13,072	**58,972**	43,608
Sand Revenue Sales/MT	**121.82**	114.80	**133.72**	120.08

	December 31, 2018	December 31, 2017
Total Assets	**520,341**	467,957
Total non-current financial liabilities	**173,655**	110,221

Notes:

(1) One metric tonne ("MT") is approximately equal to 1.102 short tons.

(2) The average Canadian to US dollar exchange rate for the three months and year ended December 31, 2018 was $0.7575 and $0.7721, respectively, (2017 - $0.7866 and $0.7704, respectively).

(3) Adjusted EBITDA is not defined under IFRS. See "Non-IFRS Measures" below.

Source delivered record performance in 2018 as the increased size and scope of operations were able to better serve the completion activity in the WCSB, when compared with 2017. In 2018 sand volumes increased by 35%, sand revenue increased by 50% and total sales revenue increased by 43%, when compared with 2017. Sand pricing improved by 11% due to contractual increases and the flow through of increased logistics costs during the year. Wellsite solutions revenue increased by $12.4 million, or 22%, in 2018 compared with 2017, primarily due to a 38% increase in trucking revenues associated with the increased sand volumes and increased Sahara rental revenue. Sahara rental revenue increased as the fleet of six units that were available at year end were utilized at 61% throughout 2018 compared to a 78% utilization of a three-unit Sahara fleet in 2017. Operating and general and administrative expenses for the year ended December 31, 2018 were $8.8 million higher than the year ended December 31, 2017 at $33.3 million, mainly due to the significant growth of the organization and corresponding increase in the number of employees combined with an increase in selling expenses due to the increase in sand volumes during the year. For 2018, Adjusted EBITDA was $59.0 million, which was $15.4 million, or 35%, higher than the $43.6 million of Adjusted EBITDA generated in 2017 and the Net Loss decreased by $6.1 million, or 68%, to $2.9 million compared to a Net Loss of $8.9 million in 2017.

($000's, except MT and per unit amounts)	Three months ended December 31 2018	2017	Year ended December 31 2018	2017
Gross Margin	**$3,703**	$13,618	**$69,015**	$51,623
Cost of Sales – depreciation and depletion	**3,253**	3,998	**20,274**	11,948
Adjusted Gross Margin(1)	**6,956**	17,616	**89,289**	63,571
Gross Margin/MT	**$9.92**	$24.43	**$26.95**	$27.14
Adjusted Gross Margin/MT(1)	**$18.64**	$31.61	**$34.87**	$33.42
Percentage of Mine Gate Sand Volumes	**15%**	30%	**10%**	14%
Percentage of Sand Volumes Sold in the WCSB	**85%**	70%	**90%**	86%
Sales Mix Impact of Mine Gate Sales/MT	**$5.33**	$13.35	**$2.70**	$3.05
Impact of Preferred Acquisition Inventory Acquired at Fair Value/MT	$—	$2.80	**$0.74**	$0.80

Note:
(1) Adjusted Gross Margin (including on a per MT basis) is not defined under IFRS, see "Non-IFRS Measures" below.

In the year ended December 31, 2018 Gross Margin and Adjusted Gross Margin increased by $17.4 million and $25.7 million, respectively, when compared to the year ended December 31, 2017 primarily due to a 35% increase in sand volumes. Gross Margin was $26.95 per MT and Adjusted Gross Margin was $34.87 per MT for the year ended December 31, 2018 which includes a $2.70 per MT impact from mine gate sales and a $0.74 per MT impact from the purchase of inventory in the Preferred Acquisition (as defined below) that was acquired at fair value.

Business Outlook

Turning to 2019 activity in the first quarter, our customers' activity levels have increased significantly from the fourth quarter of 2018. Based on booked jobs Source is expecting its first quarter 2019 activity levels to be in line with its activity levels in the first quarter of 2018. Source appreciates customer capital programs, and therefore demand for frac sand, could be impacted by several factors including timing of spring break up in the WCSB, commodity price fluctuations and condensate demand in the WCSB.

As E&P companies continue to shift into manufacturing mode the trend towards direct sourcing continues and Source is pleased to be working directly with five E&P customers under contracts. These sales are in addition to sales to other E&P companies that wish to direct source sand on a less formal basis, as well as traditional sales to pressure pumping customers.

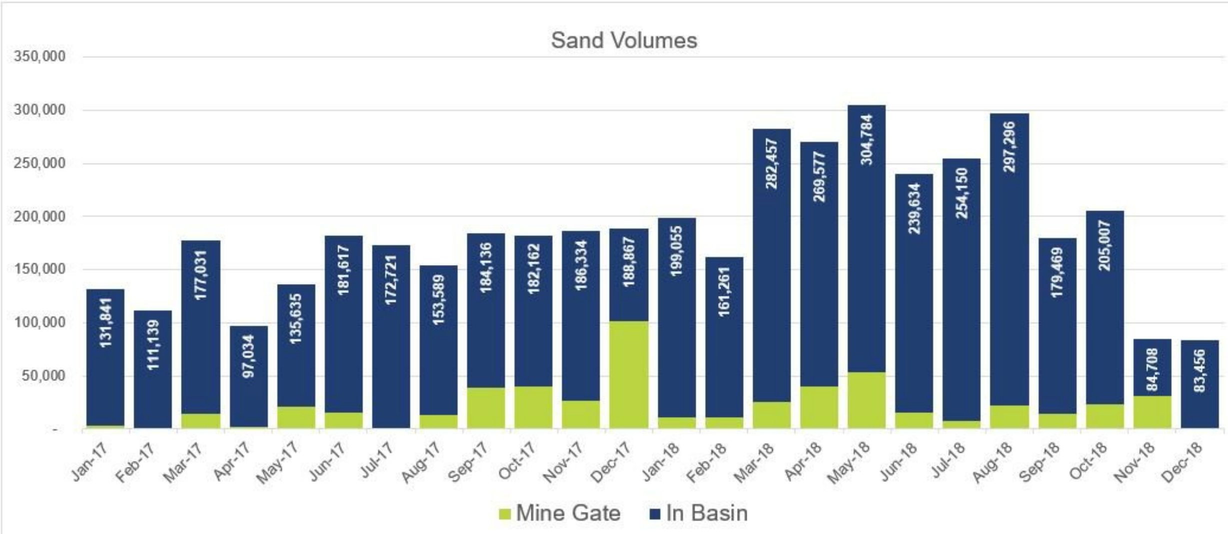
As we enter 2019, Source's capital structure is well positioned to provide us flexibility to succeed during all stages of the cycle, and we remain committed to ensuring that our capital expenditures in 2019 are funded from cash flows provided by operating activities.

Beyond 2019, we are excited by the industry prospects with improved egress and the longer-term impacts of increased demand for liquefied natural gas ("LNG") on WCSB activity levels. In addition Source deployed its first two Sahara units to the Marcellus. These units represent an important step for Source as we diversify our revenue streams into additional basins in North America.

Review of Operations

Sales

Total sales for the three months ended December 31, 2018 decreased by $21.1 million, or 28%, to $54.1 million, compared with $75.2 million generated in the three months ended December 31, 2017. The decrease was primarily driven by customer's budget exhaustion which resulted in a 33% decrease in sand volumes, with a corresponding decrease in wellsite solutions sales associated with the lower sand volumes. The decrease was partially offset by a $7.02 per MT average realized sand price increase. Total sales for the year ended December 31, 2018 increased by $125.5 million, or 43%, to $415.0 million, compared with $289.5 million generated in the year ended December 31, 2017. The increase was primarily driven by a 35% increase in sand volumes and a $13.64 per MT average realized sand price increase combined with increased wellsite solutions sales associated with the higher sand volumes.



Sand revenue is predominately made up of sand sales into the WCSB at a Source terminal or customer wellsite ("In Basin") and represents Source's core business and the utilization of its fully integrated logistics business model. Sand revenue also includes mine gate sand sales, which include the sale of products that are in lower demand in the WCSB, and are sold at the mine sites in the US, and are undertaken to maximize production efficiencies and sand volumes but are not considered Source's core business. Mine gate sand sales are typically done at a reduced sales price and result in a lower margin per tonne sold. Wellsite solutions revenue is comprised of revenue from the “last mile” logistics (i.e., from a Source terminal to the wellsite), and wellsite service offerings including Sahara units. Source believes its "last mile" services benefit customers by managing overall trucking activity, increasing reliability of supply at the wellsite and in turn creating operational efficiencies. Source also provides terminal services for certain well-completion products that aren’t produced by Source combined with proppant storage revenue. These products primarily consist of hydrochloric acid and resin coated proppants. Terminal services revenue generally follows completion activity trends in the WCSB.

Three Months Ended December 31, 2018 Compared to the Three Months Ended December 31, 2017

Source’s sand revenue for the three months ended December 31, 2018 decreased by $18.5 million, or 29%, compared to the three months ended December 31, 2017, primarily due to a 33% decrease in sand volumes (184,192 MT) partially offset by a 6% increase, or $7.02 per MT, in average realized sand price. Sand volumes decreased as a result of the significant slowdown in completion activity in the WCSB resulting from an unpredictable operating environment, very wide western Canadian oil differentials and E&P companies conservatively managing their remaining 2018 capital budgets in the fourth quarter of 2018. The average realized sand price increase was primarily due to the positive impact of a weakening Canadian dollar combined with the positive impact of the lower mine-gate sales volumes, partially offset by decreased spot prices reflecting the significant slowdown in WCSB activity. During the fourth quarter of 2018, approximately 84% of sand revenue was denominated in US dollars, which increased the average realized sand price by approximately $4.32 per MT due to the Canadian dollar weakening by 4.9%, when compared to the fourth quarter of 2017. Mine gate sales of products in lower demand in the WCSB at lower average prices to achieve operational efficiencies accounted for 15% of sand volumes in the fourth quarter of 2018, compared with 30% in the fourth quarter of 2017. This decrease of 113,205 MT of mine gate sales increased the average realized sand price by approximately $6.82 per MT in the fourth quarter of 2018, compared with the fourth quarter of 2017.

Wellsite solutions revenue decreased by $3.0 million in the fourth quarter of 2018, compared with the fourth quarter of 2017, due to a 13% decrease in trucking revenue and a 51% decrease in Sahara related revenue. The decreased trucking revenue was primarily due to the 33% decrease in sand volumes with 85% of sand volumes going to the terminal or wellsite in the WCSB. Sahara utilization was 37% in the fourth quarter of 2018, compared with 76% utilization in the fourth quarter of 2017, reflecting the significant slow down in WCSB activity. Terminal services revenue increased by $0.4 million, or 46%,in the fourth quarter of 2018, compared with the fourth quarter of 2017, due to a 106% increase in revenue from proppant storage, partially offset by a 12% decrease in hydrochloric acid transloading revenue.

Year Ended December 31, 2018 Compared to the Year Ended December 31, 2017

Source’s sand revenue for the year ended December 31, 2018 increased by $114.0 million, or 50%, compared to the year ended December 31, 2017, due to a 658,749 MT increase, or 35%, in sand volumes combined with an 11.4% increase, or $13.64 per MT, in average realized sand price. Sand volumes increased in the year as contracted sales volumes rose by 527,800 MT, or 41.3%, as our direct contracted E&P customers were more active year-over-year particularly in the Montney and Duvernay. Direct source contracts with E&P customers are a combination of take or pay contracts and percentage of demand contracts. The minimum revenue to be recognized under the take or pay contracts from customers is shown in Note 15 to the Consolidated Financial Statements for the year ended December 31, 2018. Source also saw an increase in sand sales volumes to non-contracted E&P and pressure pumping customers. These increases were partially offset by a 7.2% decline in mine gate sales, as the North American wide pipeline constraints and the increase in domestic sand supply in the Permian significantly reduced demand in this market particularly in the fourth quarter of 2018. The average realized sand price increase was primarily due to increased demand driven by higher commodity prices for the majority of 2018, contractual price increases and the impact of flowing through higher logistics costs. Mine gate sales, which are undertaken to maximize production efficiencies, accounted for 10% of sand volumes in 2018 compared with 14% of sand volumes in 2017. The sales mix price impact of the 19,916 MT decrease in mine gate sales volumes increased the average realized sand price by approximately $0.38 per MT in 2018 compared to 2017. During 2018 approximately 75% of sand revenue was denominated in US dollars, which reduced the average realized sand price by approximately $0.28 per MT due to the Canadian dollar strengthening by 0.3%, when compared to 2017.

Wellsite solutions revenue increased by $12.4 million, or 22%, in 2018 compared with 2017, primarily due to a 38% increase in trucking revenues associated with increased sand volumes and increased Sahara rental revenue. Sahara rental revenue increased as the fleet of six units that were available at year end were utilized at 61% throughout 2018 compared to a 78% utilization of a three-unit Sahara fleet in 2017. The increased Sahara rental revenue was partially offset by lower ancillary wellsite revenues. Terminal services revenue decreased by $0.8 million, or 14%, in 2018, compared with 2017, due to a 19% decrease in revenue from transloading services for resin coated proppant and proppant storage and a 7% decrease in hydrochloric acid transloading revenue.

Cost of Sales

	Three months ended December 31		Year ended December 31	
($000's, except MT and per unit amounts)	**2018**	2017	**2018**	2017
Direct Materials	**24,065**	30,435	**184,820**	121,258
People Costs	**6,870**	8,762	**33,665**	27,845
Equipment Costs	**5,858**	5,642	**25,098**	16,394
Transportation Costs	**8,040**	10,430	**71,503**	53,275
Facility Costs	**2,276**	2,302	**10,652**	7,155
Cost of Sales	**47,109**	57,571	**325,738**	225,927
Cost of Sales - depreciation and depletion	**3,375**	3,998	**20,274**	11,948

Source owns and operates three processing facilities in Wisconsin: Sumner, Blair and Preston. The principal expenses involved in the production of frac sand are excavation, labour, utilities, transportation and maintenance costs. Until unprocessed frac sand is washed and dried it will not necessarily meet American Petroleum Institute specifications for use as a proppant and will not be a saleable product. Therefore, Source incurs excavation costs for some materials which are handled but from which it does not ultimately generate sales (rejected materials). Source also incurs costs related to sand that is washed and stockpiled as work in progress inventory. This material needs to be dried before being saleable as finished product. The ratio of rejected materials to the total amounts excavated has been, and is expected to continue to be, in line with Source's expectations, based on the core sampling Source has undertaken at the Sumner, Blair and Preston facilities.

Labour costs at Source's processing facilities represent the most significant cost of converting raw materials to finished product. Source incurs utility costs in connection with the operation of its processing facilities, primarily natural gas and electricity. Source has entered into a physical fixed price natural gas contract for a portion of its natural gas needs. The balance of Source's utility purchases are based on local market prices. Source has contracted a third party to transport the washed sand from the Sumner Facility to the Weyerhaeuser Facility, and to transport waste material back to the Sumner Facility. Source's processing facilities require periodic scheduled maintenance to ensure efficient operations. Direct and indirect labour costs, utilities, transportation and maintenance costs associated with sand processing are capitalized as a component of inventory and are included in cost of sales when that inventory is ultimately sold.

To distribute sand from its processing facilities to its terminals or to its customers' wellsites, Source purchases freight from Canadian National Railway Company and then, if applicable, incurs third party trucking costs to move the sand to its customer's wellsites. In addition to freight costs Source also incurs the following shipping charges: fuel surcharges by the transportation companies, leasing costs related to its railcars, and labour and other terminal operating costs. Costs related to rail are capitalized as a component of inventory and are included in the cost of sales when that inventory is sold. Costs directly related to moving sand or other transloaded products at Source's terminals are charged to cost of goods sold, while overhead costs of operating the terminals are recorded as operating costs of the business.

Occasionally, Source will purchase sand from third party producers. This may occur when there are third party transportation disruptions, when Source has other production constraints or when Source identifies strategic opportunities in the marketplace. When Source purchases third party sand, these costs are included in inventory until the sand is sold and then such costs are recognized in cost of goods sold.

Cost of sales depreciation and depletion include depreciation of capitalized stripping costs and depreciation of the processing equipment used to process frac sand to a final saleable product. In addition, mineral resources acquired as part of the Preston facility are depleted using a unit of production method and recorded on a per ton basis.

Cost of sales, excluding depreciation and depletion, decreased by $10.5 million, or 18%, to $47.1 million for the three months ended December 31, 2018, as compared to the three months ended December 31, 2017, while sales volumes decreased by 33%. The decrease in cost of sales is primarily due to the decrease in sales volumes, partially offset by the negative impact of a 4.9% weakening of the Canadian dollar on US dollar denominated components of cost of sales. Significant components of cost of sales are mainly US dollar denominated costs including sand processing, rail freight, and rail car leases and are therefore subject to exchange rate fluctuations. Cost of sales, excluding depreciation and depletion, per unit increased by 22.2%, or $22.95 per MT, in the three months ended December 31, 2018, compared to the same period in 2017, primarily due to decreased mine gate sales volumes which incur no freight costs, increased freight rates, increased production costs, the fixed and step-fixed cost elements of production being spread over lower sales volumes and the negative impact of a weaker Canadian dollar. Source's rail car fleet consisted of 2,612 cars at December 31, 2018, and is considered the right size to serve the business for anticipated 2019 activity levels.

Cost of sales, excluding depreciation and depletion, increased by $99.8 million, or 44%, to $325.7 million for the year ended December 31, 2018, as compared to the year ended December 31, 2017, while sales volumes increased by 35%. The increase in cost of sales is primarily due to increased costs associated with higher sales volumes, increased size and scope of operations including increased fixed and step fixed costs which were negatively impacted by the significant slowdown in activity in the last quarter of 2018, the increased volume delivered as part of the "last mile" solution for Source's customers and the increased costs associated with targeted production of desirable product, partially offset by the positive impact of a 0.3% strengthening of the Canadian dollar on US dollar denominated components of cost of sales. Cost of sales, excluding depreciation and depletion, per unit increased by $8.42 per unit, or 7.1%, primarily due to the increased freight rates, increased costs of production and decreased mine gate sales volumes which incur no freight costs, partially offset by the fixed cost elements of production being spread over higher sales volume. As part of the Preferred Acquisition all assets acquired, including inventory, were acquired at fair market value which negatively impacted cost of sales as the fair value of inventory acquired at both the mine and terminal were greater than Source's internal costs to produce would have been. The fair value of inventory acquired is estimated to have negatively impacted cost of sales in 2018 by $1.9 million, or approximately $0.74 per MT. All inventory acquired in the Preferred Acquisition was fully processed and sold by March 31, 2018.

Costs associated with sand processing equipment and overburden stripping costs are capitalized as the cost is incurred and depreciated on a unit of production basis. Costs associated with mineral resources are recognized at cost, which approximates the estimated fair value on the date of acquisition, and are depleted on a unit of production basis. Cost of sales depreciation and depletion decreased by $0.7 million for the fourth quarter of 2018 compared with the fourth quarter of 2017, primarily due to decreased production associated with lower sales volumes in the fourth quarter of 2018. Cost of sales depreciation and depletion increased by $8.3 million for the year ended December 31, 2018, as compared to the year ended December 31, 2017 due to the impact of having increased production and additional production equipment required to support the increase in sales and size and scope of operations.

Gross Margin

	Three months ended December 31		**Year ended December 31**	
($000's, except MT and per unit amounts)	**2018**	2017	**2018**	2017
Gross Margin	**3,703**	13,618	**69,015**	51,623
Cost of Sales — depreciation and depletion	**3,253**	3,998	**20,274**	11,948
Adjusted Gross Margin(1)	**6,956**	17,616	**89,289**	63,571
Gross Margin %	**6.8%**	18.1%	**16.6%**	17.8%
Gross Margin/MT	**$9.92**	$24.43	**$26.95**	$27.14
Adjusted Gross Margin %(1)	**12.9%**	23.4%	**21.5%**	22.0%
Adjusted Gross Margin/MT(1)	**$18.64**	$31.61	**$34.87**	$33.42

Note:
(1) Adjusted Gross Margin is not defined under IFRS, see "Non-IFRS Measures" below.

Adjusted Gross Margin decreased by $10.7 million and was $12.97 per MT lower, in the fourth quarter of 2018 compared to the fourth quarter of 2017, while Adjusted Gross Margin percentage also decreased 10.6%, to 12.9%. Decreases were primarily due to decreased sales volumes and fixed costs being spread over lower sales volumes, as discussed in cost of sales above, which more than offset the higher average realized sand prices. Adjusted Gross Margin increased by $25.7 million, or $1.45 per MT, for the year ended December 31, 2018, as compared to the year ended December

31, 2017, as the 35% increase in sales volumes and higher average realized sand price more than offset the increased freight and production costs discussed above.

Gross Margin of $3.7 million, or 7%, for the fourth quarter of 2018 decreased $9.9 million, or $14.51 per MT, from the fourth quarter of 2017, for the same reasons the Adjusted Gross Margin decreased. Gross margins were also positively impacted by a $0.7 million decrease in cost of sales depreciation and depletion. Gross Margin of $69.0 million for the year ended December 31, 2018 increased $17.4 million, but decreased by $0.19 per MT, compared to the year ended December 31, 2017, for the same reasons the Adjusted Gross Margin increased above, combined with an increase in cost of sales depreciation and depletion as discussed above.

Operating and General and Administrative Expense

	Three months ended December 31		Year ended December 31	
($000's, except MT and per unit amounts)	**2018**	2017	**2018**	2017
People	**3,238**	3,491	**14,295**	11,913
Equipment	**495**	265	**1,528**	1,454
Facility	**1,335**	1,848	**5,104**	3,973
Selling and Administrative	**5,387**	2,623	**12,396**	7,169
Operating and General and Administrative Expense	**10,455**	8,227	**33,323**	24,509

Source incurs general and administrative expenses related to its corporate operations, including operating its corporate offices. Significant general and administrative costs for Source include salaries for the corporate staff, facility costs for the corporate offices, professional and advisory fees and information systems related costs. Operating expenses related to overhead costs of operating the terminals are recorded as operating costs of the business.

Operating and general and administrative expenses for the fourth quarter of 2018 were $10.5 million, an increase of $2.2 million from the same period in 2017. Costs associated with people and equipment remained relatively consistent with a decrease of $0.3 million and an increase of $0.2 million respectively. Facility costs decreased by $0.5 million due to increased property tax catch up in 2017 related to acquisitions. Selling and administrative costs increased $2.8 million due to the increase in sand sales volumes during the year. Operating and general and administrative expenses for the year ended December 31, 2018 were $8.8 million higher than the year ended December 31, 2017 at $33.3 million, mainly due to the significant growth of the organization and corresponding increase in the number of employees combined with an increase in selling expenses due to the increase in sand sales volumes during the year.

Depreciation

Depreciation primarily consists of depreciation on property, plant and equipment that is not used in the production of frac sand and is recorded as a separate line item in the statement of operations and comprehensive income.

Depreciation expense of $3.1 million in the fourth quarter of 2018 was an increase of $1.0 million from the fourth quarter of 2017 primarily due to the increase in size and scope of the business resulting in a significant increase in property, plant and equipment balances. Depreciation expense increased $5.4 million for the year ended December 31, 2018, compared with the year ended December 31, 2017, primarily due to the increase in size and scope of the business.

Finance Expense

Finance expense is primarily composed of interest expense on: (a) the Notes; (b) the $88 million asset backed loan facility ("Credit Facility"), which include (i) a revolving credit facility with availability thereunder subject to the limit of the lesser of: (A) $88 million, and (B) the borrowing base, to be used to finance day-to-day operations of Source and its subsidiaries and for general working capital requirements, including financing receivables, inventory and capital expenditures that have been approved by the lenders, and (ii) a US$5 million standby letter of credit facility that was canceled on May 18, 2018; (c) the preferred shares obligation; (d) the amount due to related parties; and (e) the shareholder loans. These items are all further described in the notes to the Financial Statements and items (c), (d) and (e) were settled in conjunction with the completion of the Company's IPO.

Finance expenses increased by $0.4 million to $6.0 million in the fourth quarter of 2018, compared with the same period in 2017 primarily due to the additional interest accrued relating to the additional $50 million of Notes issued in the second quarter of 2018 and interest expense recorded in relation to a prepayment received from a customer. This was partially offset by a decrease in interest for the Credit Facility. Finance expenses decreased by $7.4 million for the year ended December 31, 2018, compared with the year ended December 31, 2017, primarily due to decreased accretion as 2017 included $3.2 million of accretion expense associated with a partial Note repayment in the second quarter of 2017 and decreased professional fees.

Other Expense and Income

During 2018 Source incurred a loss on asset disposal of $4.6 million compared with $nil in 2017. The loss on asset disposal was associated with the disposal of land and other assets in Texas deemed non-core to Source's operations and plans going forward.

Source recorded $2.4 million in share based compensation for the year ended December 31, 2018 and a $0.4 million recovery in the fourth quarter of 2018 associated with the deferred share units ("DSUs"), restricted share units ("RSUs"), performance share units ("PSUs") and accrued expense related to the stock options ("Options"). The initial grant of Options at the time of the IPO was the first grant, and one-third of the Options vested immediately, with the remaining two-thirds vesting in 2018 and 2019 respectively, resulting in a larger expense being recognized in 2017. Future grants of Options will vest, as will grants of RSUs and PSUs, in equal thirds over a three-year period, with the first vesting date being one year after the initial grant. DSUs are expensed upon grant and vest when a director or other participant ceases in their role and are payable only when a director or participant leaves the company.

Source recorded an unrealized gain on derivative of $1.5 million for the year ended December 31, 2018 and a unrealized loss of $0.4 million in the fourth quarter of 2018, compared with a $1.6 million unrealized gain in 2017 and a $1.3 million loss in the fourth quarter of 2017. The derivative loss or gain fluctuates with changes in the US dollar to Canadian dollar exchange rates combined with other inputs into the valuation technique and their corresponding impact on the foreign exchange rate collars.

Source realized a foreign exchange gain of $0.1 million in the fourth quarter of 2018, compared with a $2.0 million gain in the fourth quarter of 2017. The 2017 gain was generated from a change in the Canadian dollar to US dollar foreign exchange rate from the date that the US$80 million Preferred Acquisition was approved and the closing date as a result of the US dollar foreign exchange forward contracts entered into on date of Board approval. For the year ended December 31, 2018, Source realized a foreign exchange gain of $0.6 million compared with a gain of $0.9 million in 2017. Foreign exchange loss or gain fluctuates with settlement of US dollar denominated accounts receivables and payables and changes in the corresponding Canadian dollar exchange rates.

Source recorded a tax recovery in the fourth quarter of 2018 of $0.4 million, compared to a recovery of $2.1 million in the fourth quarter of 2017. The reorganization in April 2017 changed Source's organizational structure from a series of partnerships to a corporate structure, which caused a more traditional tax provision to be recorded. Source has not recorded any current tax expense in 2018, primarily due to the US tax reform allowing for 100% tax deductions on qualifying machinery and equipment purchases.

Summary of Quarterly Results

($000's, except MT and per unit amounts)	2017				2018			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Sand Sales MT	*420,011*	*414,286*	*510,446*	*557,363*	*642,773*	*813,995*	*730,915*	*373,171*
Sand Revenue	51,630	50,555	62,232	63,986	86,884	110,281	99,804	45,459
Wellsite Solutions	10,535	16,629	17,439	10,308	17,270	20,758	21,937	7,299
Terminal Services	2,267	1,475	1,547	894	1,221	1,174	1,633	1,307
Sales	64,432	68,659	81,218	75,188	105,375	132,213	123,374	54,065
Cost of Sales	53,155	55,420	59,779	57,572	78,905	100,206	99,518	47,109
Cost of Sales Depreciation	2,558	2,810	2,582	3,998	2,138	7,694	7,189	3,253
Cost of Sales	55,713	58,230	62,361	61,570	81,043	107,900	106,707	50,362
Gross Margin	8,719	10,429	18,857	13,618	24,332	24,313	16,667	3,703
Operating and General and Admin Expenses	3,884	5,718	6,680	8,227	8,007	7,641	7,219	10,455
Depreciation	1,267	1,540	1,671	2,081	2,619	2,951	3,356	3,083
Income (loss) from operations	3,568	3,171	10,506	3,310	13,706	13,721	6,092	(9,835)
Other expense (income):								
Loss (gain) on asset disposal	—	(3)	—	(3)	2,396	(8)	2,598	(347)
Finance expense	9,479	9,409	3,879	5,575	4,757	4,928	5,320	5,956
Loss (gain) on derivative liability	(4,133)	(31)	1,267	1,316	376	(1,787)	(460)	368
Share based compensation expense (recovery)	—	3,870	984	1,770	905	1,304	567	(372)
Other income	(532)	(432)	(158)	(144)	(199)	(49)	(142)	(142)
Management Fees	417	—	—	—	—	—	—	—
Foreign exchange loss (gain)	681	(157)	583	(1,971)	2	(332)	(134)	(127)
Total other expense	5,912	12,656	6,555	6,543	8,237	4,056	7,749	5,336
Income (loss) before income taxes	(2,344)	(9,485)	3,951	(3,233)	5,469	9,665	(1,657)	(15,171)

($000's, except MT and per unit amounts)	2017				2018			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Income taxes expense (recovery)	(339)	(649)	942	(2,131)	1,756	466	(687)	(366)
Net Income (loss)	(2,005)	(8,836)	3,009	(1,102)	3,713	9,199	(970)	(14,805)
Net Income (loss) Per Share ($/Share)	(0.08)	(0.24)	0.08	(0.02)	0.06	0.15	(0.02)	(0.22)
Diluted Net Income (loss) Per Share ($/Share)	(0.08)	(0.24)	0.06	(0.02)	0.06	0.15	(0.02)	(0.22)
Net Income (loss)	(2,005)	(8,836)	3,009	(1,102)	3,713	9,199	(970)	(14,805)
Interest	6,609	3,394	2,987	3,631	3,767	4,157	4,381	4,798
Income taxes	(339)	(649)	942	(2,131)	1,756	466	(687)	(366)
Depreciation	1,267	1,540	1,671	2,081	2,619	2,951	3,356	3,083
Cost of Sales Depreciation	2,558	2,810	2,582	3,998	2,138	7,694	7,189	3,253
EBITDA(1)	8,090	(1,741)	11,191	6,477	13,993	24,467	13,269	(4,037)
Add:								
Loss (gain) on asset disposal	—	(3)	—	(3)	2,396	(8)	2,598	(347)
Finance expense	2,870	6,015	892	1,944	990	771	939	1,158
Loss (gain) on derivative liability	(4,133)	(31)	1,267	1,316	376	(1,787)	(460)	368
Share based compensation expense	—	3,870	984	1,770	905	1,304	567	(372)
Management Fees	417	—	—	—	—	—	—	—
Transaction and professional fees	—	849	—	—	—	—	—	—
Preferred Acquisition inventory acquired at fair value	—	—	—	1,568	1,884	—	—	—
Adjusted EBITDA(1)	7,244	8,959	14,334	13,072	20,544	24,747	16,913	(3,230)
Sand Revenue Sales/MT	122.93	122.03	121.92	114.80	135.17	135.48	136.55	121.82
Gross Margin	8,719	10,429	18,857	13,618	24,332	24,313	16,667	3,703
Cost of Sales Depreciation	2,558	2,810	2,582	3,998	2,138	7,694	7,189	3,253
Adjusted Gross Margin(1)	11,277	13,239	21,439	17,616	26,470	32,007	23,856	6,956
Gross Margin/MT	20.76	25.17	36.94	24.43	37.85	29.87	22.80	9.92
Adjusted Gross Margin/MT(1)	26.85	31.96	42.00	31.61	41.18	39.32	32.64	18.64

Note:

(1) EBITDA, Adjusted EBITDA and Adjusted Gross Margin are not defined under IFRS see "Non-IFRS Measures" below.

Total sales for the fourth quarter of 2018 were 56% lower than the third quarter of 2018, primarily due to a 49% decrease in sand volumes primarily as a result of decrease in the WCSB activity levels during the fourth quarter of 2018. Source's sand revenue for the fourth quarter of 2018 decreased by $54.3 million, or 54%, compared to the third quarter of 2018, due to a 49% decrease in sand volumes (357,744 MT) and a decrease of $14.73 per MT in average realized sand price. Decreased sand volumes were primarily due to significant slowdown in completion activity in the WCSB resulting from an unpredictable operating environment, very wide western Canadian oil differentials and E&P companies conservatively managing their remaining 2018 capital budgets in the fourth quarter of 2018. The decrease in the average realized sand price was due to higher mine gate sales volumes and decreased spot prices due to softening of demand, partially offset by the weakening of the Canadian dollar. Mine gate sales accounted for 15% of sand volumes in the fourth quarter of 2018 compared with 6% of sand volumes in the third quarter of 2018. The sales mix price impact of the 10,477 MT increase in mine gate sales volumes decreased the average realized sand price by approximately $9.25 per MT in the fourth quarter of 2018 compared with the third quarter of 2018. During the fourth quarter of 2018 approximately 84% of sand revenue was denominated in US dollars, which increased the average realized sand price by approximately $1.17 per MT due to the Canadian dollar weakening by 1.3%, when compared with the third quarter of 2018.

Wellsite solutions revenue decreased by $14.6 million in the fourth quarter of 2018, compared with the third quarter of 2018, primarily due to a 44% decrease in Sahara related revenues and a 72% decrease in trucking revenue coinciding with the 49% decrease in sand volumes. Sahara utilization was 37% in the fourth quarter of 2018 versus 71% in the third quarter of 2018 due to decreased demand related to the significant slowdown of activity in the WCSB. Terminal services revenue decreased by $0.3 million, or 20%, in the fourth quarter of 2018, compared with the third quarter of 2018, due to a 43% decrease in hydrochloric acid transloading revenue, partially offset by a 1% increase in revenue from transloading services for resin coated proppant and proppant storage.

Cost of sales, excluding depreciation and depletion, decreased by $52.4 million, or 53%, to $47.1 million in the fourth quarter of 2018 compared to the third quarter of 2018, primarily due to sales volumes decreasing by 49%, partially offset by the negative impact of a 1.3% weakening of the Canadian dollar on US dollar denominated components of cost of sales. Cost of sales, excluding depreciation and depletion, per unit decreased by $9.92 per MT, or 7%, in the fourth quarter of 2018 compared to the third quarter of 2018, primarily due to increased mine gate sales volumes which incur no freight costs, partially offset by the fixed cost elements of production being spread over less units and the negative impact of a 1.3% weakening of the Canadian dollar on US dollar denominated components of cost of sales. Cost of sales depreciation and depletion decreased by $3.9 million for the fourth quarter of 2018 compared with the third quarter of 2018 primarily due to decreased production associated with lower sales volumes.

Adjusted Gross Margin decreased $16.9 million and $14.00 per MT, in the fourth quarter of 2018 compared with the third quarter of 2018, primarily due to very low margin mine gates sales during the fourth quarter of 2018 to maintain production efficiencies where the decrease in realized sand price more than offset the cost of sales savings. Gross Margin decreased $13.0 million, or $12.88 per MT, in the fourth quarter of 2018, compared with the third quarter of 2018, due to the decreased Adjusted Gross Margin discussed above.

Operating and general and administrative expenses for the fourth quarter of 2018 increased $3.2 million from the third quarter of 2018 to $10.5 million primarily due to the increase in sand sales volumes during the year.

Source's business is seasonal in nature with the majority of activity normally being in the first, third and fourth quarters of the year. The least activity is usually in the second quarter, due to spring break-up. Spring break-up occurs for a period of approximately eight weeks between March and June as the frost comes out of the roads in western Canada and hauling weight restrictions are put in place. The severity of the winter snowfalls and the amount of moisture received during this period impact the length of spring break-up. As a result, Source's operating results may vary on a quarterly basis. In addition, some exploration and production areas in northern Canada are accessible only in the winter months when the ground is frozen. There are other factors that will impact the Company's activities quarter to quarter including commodity prices and completion activity levels of E&P companies.

As a general industry practice, frac sand washing facilities in Wisconsin are not operated during the winter months. However, Source's sand washing facility at the Sumner Facility is fully enclosed and heated, making it capable of operating year-round. Winter operations at the Sumner Facility are an important aspect of Source's business, as the WCSB is seasonally busiest in the winter months. Regardless of its ability to wash sand in the winter, Source excavates and washes more sand than current delivery requirements during the warmer months when Source's processing facilities are more efficient. The excess sand is placed in stockpiles that feed drying operations throughout the year. Source's Blair Facility and Preston Facility washing plants are not enclosed and therefore are not operated during the winter months, but the dry plants are operated year-round.

Select Annual Information	**Year ended December,31**		
($000's, except MT and per unit amounts)	**2018**	2017	2016
Sales	**415,027**	289,498	139,199
Net Income (Loss)	**(2,865)**	(8,935)	(43,402)
Net Income (Loss) per share ($/share)	**(0.04)**	(0.19)	(1.82)
Diluted Net Income (Loss) per share ($/share)	**(0.04)**	(0.19)	(1.82)

	December 31, 2018	December 31, 2017	December 31, 2016
Total Assets	**520,341**	467,957	219,406
Total non-current financial liabilities	**173,655**	112,361	239,549

Liquidity and Capital Resources

Free Cash Flow	**Year ended December 31**	
($000's, except MT and per unit amounts)	**2018**	2017
Cash flows provided by (used by) operating activities	**75,838**	6,478
Financing expense paid	**(15,586)**	(17,130)
Maintenance and sustaining capital spend	**(11,553)**	(7,187)
Repayment of finance lease obligations	**(1,148)**	(1,227)
Proceeds on contract liabilities, net of satisfaction of performance obligations	**(5,026)**	861
Onerous lease costs	**—**	(324)
Preferred acquisition inventory acquired at fair value	**1,884**	1,568
Transaction and professional fees	**—**	849
Management fee	**—**	417
Free Cash Flow (1)	**44,409**	(15,695)

Note:

(1) Free Cash Flow is not defined under IFRS, see "Non-IFRS Measures" below. The reconciliation to the comparable IFRS measure can be found in the table above.

Source generated $44.4 million of Free Cash Flow in 2018, compared with $(15.7) million in 2017, which was used to partially fund the growth capital spend of $56.4 million ($43.3 million in 2017) and purchase of shares under NCIB of $1.3 million ($nil in 2017). Source funded its remaining spend in 2018 through a combination of amounts available under the existing Credit Facility and the additional $50 million of Notes issued. Source funded its remaining spend in 2017 through a combination of funds received from equity issuances and available credit facility.

Source operates in a working capital and capital expenditure intensive industry where capital is required to fund working capital growth and continued development of its transload terminal network and processing facilities. To date, cash flows provided by operating activities, amounts available under the Notes, the Credit Facility and equity offerings have been the primary sources of liquidity that allow Source to meet its financial requirements to grow and operate its business operations in the short and long term. Source intends to fund future working capital and capital expenditures using cash flows from operating activities, amounts available under the existing Credit Facility and additional debt or equity issuances as may be required. The availability of any additional future funding will depend on, among other things, operating performance and the current state of the equity and debt capital markets.

Capital Expenditures	**Three months ended December 31**		**Year ended December 31**	
($000's, except MT and per unit amounts)	**2018**	2017	**2018**	2017
Terminal Expansion	**3,326**	12,773	**16,181**	17,439
Wellsite Solutions	**6,608**	1,933	**16,749**	4,877
Production Expansion	**7,159**	6,382	**28,314**	15,990
Overburden Removal	**1,862**	1,153	**6,331**	7,567
Other	**144**	2,305	**403**	4,642
Capital Expenditures	**19,099**	**24,546**	**67,978**	**50,515**

Source's capital expenditures fall into three main categories: capital expenditures at existing terminals and mine facilities to make improvements and maintain operations, growth capital expenditures for new capacity to grow production or distribution, and overburden removal. Capital expenditures for the fourth quarter of 2018 were $19.1 million, a decrease of $5.4 million from the fourth quarter of 2017. The decreased capital expenditures were primarily driven by increased terminal expansion in the fourth quarter of 2017 including expenditures for the new Fox Creek terminal and expansion of the existing Wembley terminal, partially offset by an increase in expenditures associated with new Sahara units. Capital expenditures for the year ended December 31, 2018 were $17.5 million higher than the year ended December 31, 2017 primarily due to increased production expansion and expenditures associated with new Sahara units. Capital expenditures for the fourth quarter of 2018 were $3.7 million higher than the third quarter of 2018 primarily due to increase in expenditures associated with new Sahara units. Source has grown its Sahara fleet to six units as of December 31, 2018 and in 2019 has deployed two Sahara units into the US market place to service the Marcellus basin.

Source's capital management policy is to maintain a strong capital base that optimizes Source's ability to grow, maintain investor and creditor confidence and to provide a platform to create value for its stakeholders. Source considers its capital structure to include Source's equity, the Notes and Credit Facility and manages its capital structure through various means including monthly management meetings and quarterly board meetings including regular reviews of financial information, such as budgets and forecasts. Source monitors its capital based on its then-current working capital, available bank line, projected cash flows provided by operating activities and anticipated capital expenditures. Source management prepares annual capital expenditure and operating budgets, which are approved by the Board, and are regularly reviewed and updated as necessary.

In order to maintain or adjust the capital structure, Source may issue equity securities, seek debt financing and adjust its capital spending to manage its current and projected capital structure. Source's ability to raise additional debt or equity financing is impacted by external conditions, including regional and global economic conditions. Source continually monitors economic and general business conditions.

Source's share capital is not subject to external restrictions but the amount of the Credit Facility is determined with reference to current inventory and accounts receivable.

Source's capital management policy has not changed during the years ended December 31, 2018 or December 31, 2017.

Source intends to meet its future capital requirements primarily through cash flows provided by operating activities, the Credit Facility and by raising additional debt and equity issuances as required. Source expects these sources will be sufficient to meet its capital needs. However, Source's ability to fund future operating expenses and capital expenditures, to make scheduled payments of interest on the Notes and the Credit Facility and to satisfy any of Source's other present or future debt obligations will depend on Source's future operating performance which will be affected by general economic, financial and other factors, including the risks described under the heading "Business Risks" below.

On December 8, 2016, the Company's wholly owned subsidiaries, Source Energy Services Canada LP and Source Energy Services Canada Holdings Ltd. (the "Note Issuers") issued the original $130.0 million of 10.5% senior secured first lien notes due on December 15, 2021 and on May 31, 2018 the Note Issuers issued an additional $50.0 million under the original note indenture, proceeds of which were used to pay down existing balances on the Credit Facility, (collectively the "Notes"). The Notes are secured by a fixed and floating charge over all the assets of the business except accounts receivable and inventory, on which the Notes carry a second charge. Each holder of the original note issuance was entitled to a relevant right of 4% of the equity value of the Note Issuers upon an initial public offering and various liquidation or change of control events. On May 29, 2017, Source elected to settle these relevant rights through the issuance of 1,005,831 common shares of the Company ("Common Shares") to the holders of the original Notes. There were no relevant rights granted on the additional Notes issued on May 31, 2018. There are prepayment options, where the Note Issuers may redeem 35% of the aggregate principal amounts of the Notes with the net proceeds of an equity offering at a redemption price of 110.5% of the principal amount. The Note Issuers may also redeem all or part of the Notes at any time prior to December 15, 2018 for 100% of the principal plus accrued and unpaid interest and the applicable premium as defined in the corresponding trust indenture. After December 15, 2018, the principal amount of the Notes may be redeemed in whole or in part at the applicable percentage (2018 - 107.875%, 2019 - 103.9375%, 2020 - 100%), plus accrued and unpaid interest. The prepayment option has been classified as a derivative liability and is measured at fair value through profit or loss. In connection with the closing of the IPO, Source exercised its right to repay a portion of the Notes, and on June 5, 2017 it repaid $22.3 million of the principal amount of the original Notes along with accrued interest and a make-whole premium of 10.5%. At December 31, 2018, the principal outstanding on the Notes was $157.7 million.

At December 31, 2018, the fair value of the Notes prepayment option, an embedded derivative in a customer contract that includes foreign exchange rate collars (see “Fair Value of Financial Instruments” below), and offsetting foreign exchange rate collars to manage embedded derivative risk in the customer contract was $1.3 million ($2.8 million - December 31, 2017). Changes in fair values of derivative liabilities are recorded through the Consolidated Statements of Operations and Comprehensive Income (Loss). Source has recorded a fair value loss on the Notes’ prepayment option plus the exchange rate collars and embedded derivative of $0.4 million for the fourth quarter of 2018 (fourth quarter of 2017 – loss of $1.3 million). For the year ended 2018 a $1.5 million gain on derivative liability has been recognized, compared with a $1.6 million gain in 2017.

On May 18, 2018 the Company increased the Credit Facility from $70.0 million to $88 million. On September 14, 2018 the Credit Facility was amended to extend the term for another year to now mature on December 8, 2020 and also to cancel the US$5 million standby letter of credit facility. The Credit Facility is secured by a floating first lien charge on the accounts receivable and inventory of Source under a general security agreement and a second lien charge on all other assets of the business. The amount available under the general operating facility is subject to a borrowing base formula applied to accounts receivable and inventories. As of December 31, 2018, $nil was drawn under this facility (there was $4.6 million of cash on hand and unamortized finance costs of $0.5 million). The Credit Facility was being used to support $19.5 million of letters of credit leaving $36.2 million of liquidity available. The borrowing base is updated monthly. Source is subject to externally imposed capital requirements for the Credit Facility, requiring Source Energy Services Canada LP to maintain a springing fixed charge ratio of 1.25:1 to be measured when Source’s excess availability is less than 20% of the lesser of the borrowing base and the operating facility. As of December 31, 2018, the excess availability was more than 20%. Source Energy Services Canada LP was in compliance with all covenants of the Credit Facility as of December 31, 2018.

Foreign Currency Risk

Source is exposed to currency price risk on sales denominated in US dollars to the extent that the receipt of payment of the US denominated accounts receivable are subject to fluctuations in the related foreign exchange rate. In addition, foreign currency risk exists on cost of manufacturing and transporting inventory for sale to the extent that the payment of those costs are foreign denominated accounts payable and are subject to fluctuations in the foreign exchange rate. Source monitors its net foreign currency exposure on a regular basis. Included in accounts receivable and accounts payable and accrued liabilities at December 31, 2018 are $14.3 million (December 31, 2017 - $34.1 million) and $24.5 million (December 31, 2017 - $18.9 million) denominated in foreign currency, respectively. The net effect of each 1% change in foreign exchange would have an impact on net income of $0.3 million for the three months ended December 31, 2018 (December 31, 2017 - $0.1 million).

Cash and Net Working Capital

As at December 31, 2018, Source had $4.6 million cash on hand ($4.6 million of cash on hand less $nil drawn on Credit Facility) and had senior long-term debt outstanding of $148.5 million, as compared to $129.3 million as at December 31, 2017. For the fourth quarter of 2018, Source had cash flows provided by operating activities of $26.6 million compared to cash flows used by operating activities of $25.5 million for the same period in 2017, primarily due to the $31.5 million increase in total current assets less total current liabilities (the “Net Working Capital”), partially offset by a $13.7 million decrease in net income for the quarter. Capital expenditures for the three months ended December 31, 2018 were $19.1 million compared to $24.5 million in the same period in 2017. For 2018, Source had cash flows provided by operating activities of $75.8 million compared to cash flows provided by operating activities of $6.5 million for the same period in 2017, primarily due to the $16.3 million decrease in Net Working Capital and a $6.1 million decrease in net loss for the year ended December 31, 2018. Capital expenditures for 2018 were $68.0 million compared to $50.5 million in 2017.

Capital expenditures in both periods were funded through a combination of cash flows provided in operating activities and amounts available under the Credit Facility.

Net Working Capital as at December 31, 2018 was $63.0 million, as compared to $33.0 million as at December 31, 2017. The increase was primarily due to higher inventory balances as at December 31, 2018, combined with a decrease in current liabilities due to the successful maturity extension of the Credit Facility and the subsequent reclassification to long-term debt during the first quarter of 2018, partially offset by the decrease in accounts receivable due to lower sales volumes in the three months ended December 31, 2018.

Contract Liabilities

Source entered into an agreement with one of its customers, effective January 1, 2018, where Source received $14.8 million ($11.5 million US dollars) as a prepayment for future purchases of proppant. In consideration of the prepayment, the price per MT to the customer was reduced for each MT of sand sold to the customer. The cash price per MT is also reduced for each MT of sand sold or pumped by the customer. During the fourth quarter of 2018, $0.8 million of this obligation was satisfied with a balance of $5.9 million remaining.

Contractual Obligations

Source has various lease commitments regarding equipment, railcars, a physical natural gas contract, land leases and office space. The leases expire between February 2019 and September 2031. The financial liabilities on Source's Consolidated Statement of Financial Position consist of the Notes, Credit Facility and finance leases. Source's planned cash outflows relating to lease commitments and financial liabilities are outlined in the table below:

($000's, except MT and per unit amounts)	**Total**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023 and thereafter**
Finance leases	1,763	594	386	231	427	125	—
Leases and other commitments	87,413	25,936	17,752	14,733	12,567	5,263	11,162
Credit Facility(1)	—	—	—	—	—	—	—
Notes	206,664	16,560	16,560	173,544	—	—	—

Note:

(1) Interest payments on such balances have been excluded from the above table as the amount and timing of any interest payments will fluctuate depending on balances outstanding and applicable interest rates. Based on December 31, 2018 balances and interest rates, and assuming amounts stay outstanding until maturity, estimated total interest expense would be $nil.

Source is a party to contracts with numerous customers. Source's customers consist primarily of E&P companies and pressure pumping companies operating in the WCSB. Source has structured contracts with customers outlining volume commitments and in some cases fixed pricing, the terms of which vary from one to three years. This mitigates the impact of any non-payment or non-performance by, or significant reduction in purchases by, any of these contracted customers. Source's customers are also serviced on a spot basis where volume thresholds are not set and orders are serviced on an as-available basis at prevailing market prices.

In the ordinary course of conducting business, Source occasionally becomes involved in legal proceedings relating to contracts, environmental issues or other matters. While any proceeding or litigation has an element of uncertainty, management of Source believes that the outcome of any pending or threatened actions will not have a material adverse effect on the business or on the financial condition of Source.

Off-Balance Sheet Arrangements

Source does not have any off-balance sheet arrangements at this time.

Outstanding Shares

The weighted average number of Common Shares outstanding for the three months and year ended December 31, 2018 was 61,262,427 and 61,478,796 (three months and year ended December 31, 2017 - 57,033,291 and 44,454,714, respectively).

	Three months ended December 31		Year ended December 31	
	2018	2017	**2018**	2017
Common Shares outstanding, beginning of period	**61,551,712**	50,316,715	**61,551,712**	23,845,618
Shares repurchased and canceled under Normal Course Issuer Bid	(289,285)	—	(72,916)	—
Issued upon closing of IPO	—	—	—	12,009,133
Issued on repayment of preferred share obligation	—	—	—	2,584,258
Issued pursuant to November 7, 2017 equity offering	—	6,716,576	—	1,662,164
Issued on settlement of shareholder loan	—	—	—	3,755,554
Issued on settlement of Relevant Transaction Rights	—	—	—	597,987
Weighted average common shares outstanding, end of period	**61,262,427**	57,033,291	**61,478,796**	44,454,714
Common shares issuable pursuant to conversion option of Class B Shares (1)	—	—	—	—
Weighted average number of diluted common shares outstanding, end of period	**61,262,427**	57,033,291	**61,478,796**	44,454,714

Note:
(1) Only attributable to non-controlling interest shareholders when in an income position.

As at March 14, 2019, Source had issued and outstanding (i) 60,936,712 Common Shares; (ii) 1,300,154 Class B shares, each redeemable for a Common Share on a one-to-one ratio at the option of the holder; and (iii) 2,580,843 stock options. See "Corporate Structure" in the AIF.

Transactions between Related Parties

During the year ended December 31, 2018, Source contracted with a company that is partially owned by a close member of the CEO's family. This company provided various project management services in locations where Source did not have adequate construction management or construction execution resources. The company also performed various civil and mechanical construction tasks and provided construction materials. This company billed Source $2.1 million for the year ended December 31, 2018 (December 31, 2017 - $2.9 million), of which $nil was included in accounts payable and accruals as at December 31, 2018 (December 31, 2017 - $1.3 million).

Proposed Transactions

Source does not have any proposed transactions at this time other than those occurring in the ordinary course of business.

Controls and Procedures

The Company is required to comply with National Instrument 52-109 - *Certification of Disclosure in Issuers' Annual and Interim Filings*. The certificate for annual filings requires the Chief Executive Officer and the Chief Financial Officer to certify the design of Source's disclosure controls and procedures ("DC&P") and internal control over financial reporting ("ICFR") as at December 31, 2018. There were no material weaknesses in the design of the DC&P and the ICFR at December 31, 2018, and no changes in ICFR during the financial year ended December 31, 2018 that have materially affected, or are reasonably likely to materially affect Source's ICFR. The control framework used to design the Company's ICFR is the framework in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. While the Company's certifying officers believe that the Company's DC&P and ICFR provide a reasonable level of assurance with regard to their effectiveness, a control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system will be met and it should not be expected that the control system will prevent all errors or fraud.

Business Risks

The following business risks are not a complete list of risks and for additional information regarding the risks that Source is exposed to, see the disclosure provided under the heading "Risk Factors" in the AIF.

Source's operations are subject to operating risks that are often beyond its control and could adversely affect production levels and costs

Source's mining, processing and production facilities, its logistics operations and any future properties it develops or may acquire in the future are and will be subject to risks normally encountered in the frac sand industry. These risks include:

- changes in the price and availability of transportation;
- inability to obtain necessary production equipment or replacement parts;
- inclement or hazardous weather conditions, including flooding, and the physical impacts of climate change;
- unanticipated ground, grade or water conditions;
- inability to acquire or maintain necessary permits or mining or water rights;
- late delivery of supplies;
- changes in the price and availability of natural gas or electricity that Source uses as fuel sources for its frac sand plants and equipment;
- technical difficulties or failures;
- cave-ins or similar pit wall failures;
- environmental hazards, such as unauthorized spills, releases and discharges of wastes, tank ruptures and emissions of unpermitted levels of pollutants;
- industrial accidents;
- changes in laws and regulations (or the interpretation thereof) related to the mining and oil and natural gas industries, silica dust exposure or the environment;
- inability of Source's customers or distribution partners to take delivery;
- reduction in the amount of water available for processing;
- fires, explosions or other accidents; and
- facility shutdowns in response to environmental regulatory actions.

The occurrence of any of these events could have a material adverse effect on Source's business, financial position, results of operations and cash flows.

Source's business may be adversely affected by changing economic conditions beyond its control, including decreases in oil and natural gas development

Source's revenue is closely tied to conditions in the oil and natural gas industry in which its customers operate, and more broadly to general economic conditions. Source's product and services are used primarily in oil and gas exploration and production in Western Canada and the United States. Consequently, economic downturns and particularly weakness in the oil and natural gas market may lead to a significant decrease in demand for Source's products and services or depress utilization rates and the prices for the products and services Source sells. During periods of expansion in Source's respective end markets, Source generally has benefited from increased demand for its products and services. However, during recessionary periods in Source's end markets, Source may be adversely affected by reduced demand for its products and services. Weakness in Source's end markets, such as a decline in oil and natural gas exploration and production, may in the future lead to a decrease in the demand for Source's products and services or the price Source can charge for its products and services, which could adversely affect Source's operating results by decreasing revenues and profit margins. Deterioration in the oil and natural gas industry could have a material adverse effect on Source's business, financial position, results of operations and cash flows in the future.

Source's business and financial performance depend on the level of activity in the oil and natural gas industry

Substantially all of Source's revenues are derived from the sale of proppant to companies in the oil and natural gas industry in the WCSB. As a result, Source's operations are dependent on the levels of activity in oil and natural gas exploration, development and production primarily in the WCSB. More specifically, the demand for the proppants Source produces is closely related to the number of oil and natural gas wells completed in geological formations that Source serves and where sand-based proppants are used in hydraulic fracturing activities. These activity levels are affected by both short and long-term trends in oil and natural gas prices, among other factors. In recent years, oil and natural gas prices and, therefore, the level of exploration, development and production activity, have experienced a sustained decline from the highs in the latter half of 2014. Increasing global supply of oil, including a decision by the OPEC to sustain its production levels in spite of the decline in oil prices, in conjunction with weakened demand from slowing economic growth in the Eurozone and China, created downward pressure on crude oil prices resulting in reduced demand for Source's products and pressure to reduce its product prices. If conditions continue to deteriorate and persist, this will adversely impact Source's operations as could conditions such as economic, environment, regulatory and pipeline egress issues in Canada. Furthermore, the availability of key resources that impact drilling activity has experienced significant fluctuations and could impact demand for the Company's products. A prolonged reduction in oil and natural gas prices would generally depress the level of oil and natural gas exploration, development, production and well completion activity and would result in a corresponding decline in the demand for the proppants Source produces. Such a decline would have a material adverse effect on Source's business, results of its operations, and its financial condition. Furthermore, the commercial development of economically viable alternative energy sources (such as wind, solar, geothermal, tidal, fuel cells and biofuels) could have a similar effect. Any future decreases in the rate at which oil and natural gas reserves are discovered or developed, whether due to the passage of legislation, increased governmental regulation leading to limitations, or prohibitions on exploration and drilling activity, including hydraulic fracturing, or other factors, could have a material adverse effect on Source's business and financial condition, even in a stronger oil and natural gas price environment.

Downturn in business could result in potential impairment of property, plant and equipment

Decreases in commodity prices have had, and may in the future have, a negative impact on industry drilling and well completion activity, which affects the demand for frac sand. Should energy industry conditions deteriorate, there is a possibility that property, plant and equipment may be impaired in a future period. Any resulting non-cash impairment charges to earnings may be material. Specific uncertainties affecting Source's estimated fair value include the impact of competition, the prices of frac sand, future overall activity levels and demand for frac sand, the activity levels of Source's significant customers, and other factors affecting the rate of Source's future growth. These factors will continue to be reviewed and assessed going forward. Additional adverse developments with regard to these factors could have a further negative impact on Source's fair value.

Source relies on a small number of customers for the majority of its revenue

Source relies on a small number of large customers for most of its revenue, and the loss of one or more such customers would adversely affect Source's results of operations and cash flows. Source's five largest customers accounted for 84% of its revenue for the year ended December 31, 2018. Although a significant percentage of Source's customers are under contract, certain contracts do not provide for guaranteed volumes and can be terminated on short notice and, on occasion, certain customers may demand to renegotiate a contract prior to the end of its term. There can be no assurance that Source's current customers will continue their relationships with Source or that contracts that come up for renewal will be renewed or, if they are renewed, that customers will contract for the same amounts or that they will pay the same prices as they have in the past. The loss of one or more major customers, the failure to renew customer contracts, or any decrease in products or services purchased or prices paid or any other changes to the terms of service under renewed contracts could have a material adverse effect on Source's business, financial position, results of operations and cash flows. A substantial portion of Source's customer contracts, including contract renewals, are subject to competitive tender processes, and there can be no assurance that Source will be successful in acquiring new business or retaining existing business subject to competitive tender. As a result of the limited number of customers that Source currently serves, Source's operations are subject to counterparty risk. The ability or willingness of each of Source's customers to perform its obligations under an agreement with Source will depend on a number of factors that are beyond Source's control and may include, among other things, the overall financial condition of the counterparty, the condition of the Canadian and United States oil and natural gas exploration and production industry, the continuing use of frac sand in hydraulic fracturing operations and general economic conditions. In addition, in depressed market conditions, Source's customers may no longer need the amount of frac sand for which they have indicated or agreed to, or may be able to obtain comparable products at a lower price. If Source's customers experience a significant downturn in their business or financial condition, they may attempt to renegotiate Source's agreements. In addition, as agreements expire, depending on market conditions at the time, Source's customers may choose not to extend, or to adjust the terms of, these agreements which could lead to a significant reduction of sales volumes and corresponding revenues cash flows and financial condition if Source is not able to replace these expected sales volumes with new sales volumes. Additionally, even if Source were to replace any lost volumes, under current market conditions, lower prices for its product could materially reduce its revenues, cash flow and financial condition.

All of Source's frac sand is currently produced from the Sumner Facility, the Blair Facility, and the Preston Facility, and the delivery of that frac sand to Source's customers is primarily served by one rail line. Any adverse developments at a facility or on the rail line could have a material adverse effect on Source's business, financial condition and results of operations

All of Source's sand is currently derived from the Sumner Facility, the Blair Facility, and the Preston Facility which are served primarily by a single Class I rail line owned by CN. Any adverse development at the Sumner Facility, the Blair Facility, or the Preston Facility or on the rail line due to catastrophic events or weather, or any other event that would cause Source to curtail, suspend or terminate operations at its facilities, could result in Source being unable to meet its sand deliveries. Although Source maintains insurance coverage to cover a portion of these types of risks, there are potential risks associated with Source's operations not covered by insurance. There also may be certain risks covered by insurance where the policy does not reimburse Source for all of the costs related to a loss. Downtime or other delays or interruptions to Source's operations that are not covered by insurance could have a material adverse effect on Source's business, results of operations and financial condition. In addition, since Sumner Facility, the Blair Facility, and the

Preston Facility are all served by a single Class I rail line, any adverse changes to the existing rail rates, rail car leases, or other logistics costs would adversely affect Source's business operations and financial position.

Financial Instruments and Other Instruments

Risk Management Overview

Source's activities expose it to a variety of financial risks including credit risk, liquidity risk and market risk. Further quantitative disclosures are included in the Financial Statements. Source employs risk management strategies and polices to ensure that any exposures to risk are in compliance with Source's business objectives and risk tolerance levels. While the board of directors has the overall responsibility for Source's risk management framework, Source's management has the responsibility to administer and monitor these risks.

For additional information regarding the risks that Source is exposed to, see the disclosure provided under the heading "Risk Factors" in the AIF.

Fair Value of Financial Instruments

The fair values of cash, accounts receivable, accounts payable and accrued liabilities approximate their carrying values due to the short-term maturity of those instruments. The fair value of the Credit Facility approximates the carrying value as they bear interest at market floating rates consistent with market rates for similar debt. Based on the closing market price as of December 31, 2018, the fair value of the Notes were $153.8 million.

During the third quarter of 2017, Source entered into a customer contract that included foreign exchange rate collars. Under the terms of the contract, pricing would be adjusted if the daily US dollar to Canadian dollar closing exchange rate was below $1.25 or exceeded $1.40. The embedded derivative is separated from the contract and accounted for as a derivative asset or liability and is measured at fair value through profit or loss. The fair value of the derivative is based on valuation techniques that are not based on observable market data. During the second quarter of 2018, Source entered into foreign exchange rate collars to help mitigate the risk associated with the embedded derivative contained in the customer contract. The fair value of the derivative is based on the US dollar to Canadian dollar foreign exchange forward curve.

Notional amount of Contract (per month)	Exchange rate floor	Notional amount of Contract (per month)	Exchange rate ceiling	Contract expiry
USD $1,500	1.25	USD $3,000	1.36	April 30, 2020
USD $1,500	1.25	USD $3,000	1.40	April 30, 2020

Recently Issued Accounting Standards Not Yet Applied

Unless otherwise noted, the following revised standards and amendments are effective for annual periods beginning on or after January 1, 2019, with earlier application permitted.

IFRS 16 Leases

On January 1, 2019, the Company adopted IFRS 16 *Leases*. The new standard requires lessees to recognize a lease liability reflecting future lease payments and a 'right-of-use asset' ("RoU asset") for most lease contracts. The standard permits a 'simplified approach' where the liabilities will be measured at the present value of the remaining lease payments, discounted using the Company's incremental borrowing rate as of January 1, 2019. The associated RoU assets will be measured at the amount equal to the lease liability, with no impact on retained earnings. On initial adoption, the Company will use the following practical expedients permitted by the standard:

- The use of a single discount rate for a portfolio of leases with similar characteristics;
- The accounting of leases with a remaining lease term of less than twelve months as at January 1, 2019 as short-term leases for certain classes of assets;
- The accounting for lease payments as expenses on leases for which the underlying asset is of low dollar value;
- The use of hindsight in determining the lease term where the contract contains options to extend or terminate a lease; and
- The Company will not apply any grandfathering practical expedients.

Adoption of the standard will result in the recognition of additional RoU assets and lease liabilities for leases of approximately $71.0 million as at January 1, 2019.

Critical Accounting Estimates

The following discussion sets forth management's most critical estimates and assumptions in determining the value of assets, liabilities and equity.

Allowance for Doubtful Accounts

Source performs ongoing credit evaluations of its customers and grants credit based on a review of historical collection experience, current aging status, the customer's financial condition and anticipated industry conditions. Customer payments are regularly monitored and a provision for doubtful accounts is established based on specific situations and overall industry conditions.

Inventories

Source evaluates its inventory to ensure it is carried at the lower of average cost and net realizable value. Allowances are made against obsolete or damaged inventories and charged to cost of sales. The reversal of any write-down of inventory arising from an increase in net realizable value would be recognized as a reduction in cost of sales in the period in which the reversal occurred.

Depreciation and Depletion

The amounts recorded for depreciation of property and equipment are based on estimates of the useful lives of the assets and residual values. This estimated residual value and useful lives of property and equipment are reviewed at the end of each reporting period and adjusted if required.

Mineral resources are depleted using the unit-of-production method based on indicated and inferred reserves. Depletion is recorded on a per tonne basis as the reserves are mined.

Decommissioning Liabilities

The amount recorded for decommissioning liabilities and accretion expense depends on estimates of current risk-free interest rates, future restoration and reclamation expenditures, and the timing of those expenditures.

Income Taxes

The amounts recorded for deferred income taxes are based on estimates as to the timing of the reversal of temporary differences and tax rates currently substantively enacted. They are also based on estimates of the probability of Source utilizing certain tax losses in future periods and tax rates applicable to those periods.

Share Based Compensation

The fair value of stock options to purchase Common Shares is estimated at the grant date using the Black-Scholes option pricing model, which includes underlying assumptions related to the risk-free interest rate, average expected unit life, estimated forfeitures, and estimated volatility of Source. At the annual general meeting on May 3, 2018, the Shareholders approved a long term incentive program that provides for the settlement of RSUs and PSUs in Common Shares or cash. DSUs, RSUs and PSUs can be settled for cash payments and accordingly are considered a liability settled award for accounting purposes.

Cash Generating Units

The determination of cash-generating units is based on management's judgment regarding geographic proximity, shared equipment, and mobility of equipment. Management has determined that the Company's operations represent one cash-generating unit.

Impairment of Non-Financial Assets

Assets that are subject to depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs of disposal and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are largely independent cash inflows, prior to impairments of non-financial assets and are reviewed for possible reversal at each reporting date.

Embedded Derivatives

An embedded derivative is a component of a contract that modifies the cash flows of the contract. In respect of the Notes, the relevant transaction rights and the prepayment option included in the Notes represents a hybrid contract. The embedded derivatives are separated from the Note payable and accounted for as derivative liabilities. The embedded derivatives are measured at fair value through profit or loss. The fair value of the derivatives is based on prices or valuation techniques that require inputs that are not based on observable market data. The Company has a customer contract that includes foreign exchange rate collars. Under the terms of the contract, pricing will be adjusted if the daily US dollar to Canadian dollar closing exchange rate is below $1.25 or exceeds $1.40. The embedded derivative is separated from the contract and accounted for as a derivative asset or liability and is measured at fair value through profit or loss. The fair value of the derivative is based on valuation techniques that are not based on observable market data.

Fair Value of Assets and Liabilities Acquired in a Business Combination

Values are allocated to assets and liabilities acquired based on their estimated fair values at the date of acquisition. Determining the fair value of assets and liabilities acquired, as well as intangible assets that relate to such items is ultimately based on management's assessment of the value of the assets and liabilities acquired and, to the extent available, third party information and assessments. Any excess of the cost of the acquisition over the net fair value of the identifiable assets acquired is recognized as goodwill.

NON-IFRS MEASURES

This MD&A refers to certain financial measures that are not determined in accordance with IFRS. These financial measures do not have standardized meanings prescribed by IFRS and Source's method of calculating these measures may differ from the method used by other entities and, accordingly, they may not be comparable to similar measures presented by other companies. These financial measures should not be considered as an alternative to, or more meaningful than, net income (loss), Gross Margin and other measures of financial performance as determined in accordance with IFRS. Source believes that these non-IFRS measures are useful to both management and investors in providing relative performance and measuring changes in respect of Source as well as measuring Source's financial performance in the context of earnings generated to fund capital investments and meet financial obligations. More specifically, EBITDA, Adjusted EBITDA, Adjusted Gross Margin and Free Cash Flow are considered key non-IFRS measures as they reflect the ability of Source to generate earnings necessary to meet its capital investments and financial obligations. Adjusted EBITDA per MT and Adjusted Gross Margin per MT are calculated by taking the non-IFRS measures and dividing by sand volumes for the periods stated.

Adjusted EBITDA represents earnings generated to fund capital investments and meet financial obligations. It represents, for the period presented, EBITDA as adjusted to add back or deduct, as applicable, the following expenses, costs, charges or benefits incurred in such period which in management's view are not indicative of the underlying business performance: (a) finance expense excluding interest expense; (b) management fee; (c) fair value adjustment of the shareholder loan; (d) loss (gain) on asset disposal; (e) loss on impairment; (f) transaction and professional fees; (g) on November 7, 2017, Source completed an asset purchase for certain assets and operations of Preferred Proppants, LLC (the "Preferred Acquisition") including inventory acquired at fair value; (h) loss (gain) on derivative liability; (i) gain on settlement of deferred revenue; and (j) share based compensation.

EBITDA represents, for the period presented, net income (loss) plus: (a) income taxes; (b) interest expense; (c) cost of sales – depreciation; (d) depreciation; and (e) amortization, in each case to the extent deducted from net income in such period determined on a combined basis in accordance with IFRS.

Adjusted Gross Margin represents a margin more comparable to our peers. It represents, for the period presented, Gross Margin plus costs of sales – depreciation and depletion.

Free Cash Flow represents, for the period presented, cash flows provided by (used in) operating activities adjusted for financing expense paid, maintenance and sustaining capital spend need to maintain operations, mandatory debt repayments and various non-cash operating activities. Free Cash Flow is considered a key non-IFRS measure as it reflects the ability of Source to fund its discretionary capital and non-capital spend from cash flows provided by operating activities. The reconciliation to the comparable IFRS measure, Cash flows provided by (used in) operating activities, can be found on page 10.

This MD&A makes reference to these non-IFRS measures. These non-IFRS measures and other financial estimates of management are based upon variable components. There can be no assurance that these components and future calculations of non-IFRS measures will not vary. Investors are cautioned not to consider these non-IFRS measures in isolation or place undue reliance on ratios or percentages calculated using these non-IFRS measures.

Reconciliation of EBITDA and Adjusted EBITDA to Net Income

	Three months ended December 31		Year ended December 31	
($000's, except MT and per unit amounts)	**2018**	2017	**2018**	2017
Net income (loss)	**(14,805)**	(1,102)	**(2,865)**	(8,935)
Add:				
Tax expense	**(366)**	(2,131)	**1,169**	(2,179)
Interest expense	**4,798**	3,631	**17,103**	16,621
Cost of sales – depreciation and depletion	**3,253**	3,998	**20,274**	11,948
Depreciation	**3,083**	2,081	**12,009**	6,560
EBITDA	**(4,037)**	6,477	**47,690**	24,015
Add:				
Finance expense excluding interest expense	**1,158**	1,944	**3,858**	11,721
Share based compensation expense	**(372)**	1,770	**2,403**	6,625
Management fee	**—**	—	**—**	417
Loss (gain) on asset disposal	**(347)**	(3)	**4,640**	(6)
Loss (gain) on derivative liability	**368**	1,316	**(1,503)**	(1,581)
Transaction and professional fees	**—**	—	**—**	849
Preferred Acquisition inventory acquired at fair value	**—**	1,568	**1,884**	1,568
Adjusted EBITDA	**(3,230)**	13,072	**58,972**	43,608

Reconciliation of Gross Margin to Adjusted Gross Margin

	Three months ended December 31		Year ended December 31	
($000's, except MT and per unit amounts)	**2018**	2017	**2018**	2017
Gross Margin	**3,703**	13,618	**69,015**	51,623
Cost of Sales — depreciation and depletion	**3,253**	3,998	**20,274**	11,948
Adjusted Gross Margin	**6,956**	17,616	**89,289**	63,571

FORWARD-LOOKING STATEMENTS

Certain statements contained in this MD&A constitute forward-looking statements relating to, without limitation, expectations, intentions, plans and beliefs, including information as to the future events, results of operations and Source's future performance (both operational and financial) and business prospects. In certain cases, forward-looking statements can be identified by the use of words such as "expects", "estimates", "forecasts", "intends", "anticipates", "believes", "plans", "seeks", "projects" or variations of such words and phrases, or state that certain actions, events or results "may" or "will" be taken, occur or be achieved. Such forward-looking statements reflect Source's beliefs, estimates and opinions regarding its future growth, results of operations, future performance (both operational and financial), and business prospects and opportunities at the time such statements are made, and Source undertakes no obligation to update forward-looking statements if these beliefs, estimates and opinions or circumstances should change. Forward-looking statements are necessarily based upon a number of estimates and assumptions made by Source that are inherently subject to significant business, economic, competitive, political and social uncertainties and contingencies. Forward-looking statements are not guarantees of future performance. In particular, this MD&A contains forward-looking statements pertaining, but not limited, to: expectations regarding the price of proppants and sensitivity to changes in such prices; outlook for operations and sales volumes; expectations respecting future competitive conditions; industry activity levels; industry conditions pertaining to the frac sand industry; expectations regarding increased demand for and sales volumes of sand in 2019; increased activity levels and sand intensity levels in 2019; the ability of and manner by which Source expects to meet its capital needs; increased drilling and well completion activity in 2019; the continued increase of sand sales volumes and sand spot pricing in 2019; increased sand intensities for Canadian well completions; the effectiveness of internal controls over Source's internal financial reporting; and Source's objectives, strategies and competitive strengths.

By their nature, forward-looking statements involve numerous current assumptions, known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of Source to differ materially from those anticipated by Source and described in the forward-looking statements.

With respect to the forward-looking statements contained in this MD&A, assumptions have been made regarding, among other things: proppant market prices; future oil, natural gas and natural gas liquids prices; future global economic and financial conditions; future commodity prices, demand for oil and gas and the product mix of such demand; levels of activity in the oil and gas industry in the areas in which Source operates; the continued availability of timely and safe transportation for Source's products, including without limitation, accessibility of transportation by rail and truck; the maintenance of Source's key customers and the financial strength of its key customers; the maintenance of Source's significant contracts or their replacement with new contracts on substantially similar terms and that contractual counterparties will comply with current contractual terms; operating costs; that the regulatory environment in which Source operates will be maintained in the manner currently anticipated by Source; future exchange and interest rates; geological and engineering estimates in respect of Source's resources; the recoverability of Source's resources; the accuracy and veracity of information and projections sourced from third parties respecting, among other things, future industry conditions and product demand; demand for horizontal drilling and hydraulic fracturing and the maintenance of current techniques and procedures, particularly with respect to the use of proppants; Source's ability to obtain qualified staff and equipment in a timely and cost-efficient manner; the regulatory framework governing royalties, taxes and environmental matters in the jurisdictions in which Source conducts its business and any other jurisdictions in which Source may conduct its business in the future; future capital expenditures to be made by Source; future sources of funding for Source's capital program; Source's future debt levels; the impact of competition on Source; and Source's ability to obtain financing on acceptable terms.

A number of factors, risks and uncertainties could cause results to differ materially from those anticipated and described herein including, among others: the effects of competition and pricing pressures; risks inherent in key customer dependence; effects of fluctuations in the price of proppants; risks related to indebtedness and liquidity, including Source's leverage, restrictive covenants in Source's debt instruments and Source's capital requirements; risks related to interest rate fluctuations and foreign exchange rate fluctuations; changes in general economic, financial, market and business conditions in the markets in which Source operates; changes in the technologies used to drill for and produce oil and natural gas; Source's ability to obtain, maintain and renew required permits, licenses and approvals from regulatory authorities; the stringent requirements of and potential changes to applicable legislation, regulations and standards; the ability of Source to comply with unexpected costs of government regulations; liabilities resulting from Source's operations; the results of litigation or regulatory proceedings that may be brought against Source; the ability of Source to successfully bid on new contracts and the loss of significant contracts; uninsured and underinsured losses; risks related to the transportation of Source's products, including potential rail line interruptions or a reduction in rail car availability; the geographic and customer concentration of Source; the ability of Source to retain and attract qualified management and staff in the markets in which Source operates; labour disputes and work stoppages and risks related to employee health and safety; general risks associated with the oil and natural gas industry, loss of markets, consumer and business spending and borrowing trends; limited, unfavourable, or a lack of access to capital markets; uncertainties inherent in estimating quantities of mineral resources; sand processing problems; implementation of recently issued accounting standards; and the use and suitability of Source's accounting estimates and judgments.

Although Source has attempted to identify important factors that could cause actual actions, events or results to differ materially from those described in its forward-looking statements, there may be other factors that cause actions, events or results not to be as anticipated, estimated or intended. There can be no assurance that forward-looking statements will materialize or prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement. Readers should not place undue reliance on forward-looking statements. These statements speak only as of the date of this MD&A. Except as may be required by law, Source expressly disclaims any intention or obligation to revise or update any forward-looking statements or information whether as a result of new information, future events or otherwise.

Any financial outlook and future-oriented financial information contained in this MD&A regarding prospective financial performance, financial position or cash flows is based on assumptions about future events, including economic conditions and proposed courses of action based on management's assessment of the relevant information that is currently available. Projected operational information contains forward-looking information and is based on a number of material assumptions and factors, as are set out above. These projections may also be considered to contain future oriented financial information or a financial outlook. The actual results of Source's operations for any period will likely vary from the amounts set forth in these projections and such variations may be material. Actual results will vary from projected results. Readers are cautioned that any such financial outlook and future-oriented financial information contained herein should not be used for purposes other than those for which it is disclosed herein. The forward-looking information and statements contained in this document speak only as of the date hereof and the Company does not assume any obligation to publicly update or revise them to reflect new events or circumstances, except as may be required pursuant to applicable laws.