MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2020

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MANAGEMENT'S DISCUSSION AND ANALYSIS

The following Management's Discussion and Analysis ("MD&A"), dated October 29, 2020, reflects the operating and financial results of Source Energy Services Ltd. and its subsidiaries, collectively ("Source" or the "Company"), as at and for the three and nine months ended September 30, 2020 compared with the corresponding period 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 unaudited condensed consolidated interim financial statements for the three and nine months ended September 30, 2020 and 2019 and the audited consolidated financial statements for the years ended December 31, 2019 and 2018, 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. 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, among other things, 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. "Free Cash Flow" is generally used to assess the ability to fund discretionary capital and non-capital spend from cash flows provided by operating activities. Refer to '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", as well as a reconciliation to IFRS measures of the Company.

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 logistics company that focuses on the production and distribution of high quality Northern White frac sand, as well as the distribution of other bulk completion materials not produced by Source. Source provides its customers with an end-to-end solution for frac sand supported by its Wisconsin mines and processing facilities, its Western Canadian terminal network and its "last mile" logistics capabilities. Source also provides storage and logistics services for other bulk oil and gas well completion materials and has developed Sahara, a proprietary wellsite mobile sand storage and handling system.

Source's full-service approach allows customers to rely on its logistics platform 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.

Third Quarter 2020 Summary

Against a backdrop of continued volatility and uncertainty resulting from the ongoing coronavirus pandemic ("COVID-19"), Source achieved the following results for the three months ended September 30, 2020:

- realized sand sales volumes of 609,469 metric tonnes ("MT"), an 11% increase over the third quarter of 2019, and sand revenue of $65.2 million;
- distributed total volumes through Source's Western Canadian Sedimentary Basin ("WCSB") terminal network of 625,868 MT;
- even with higher activity levels seen in the third quarter, Source maintained cost control measures, resulting in a reduction of 30% for operating and general and administrative expense compared to the third quarter of 2019;
- successfully completed the renegotiation of certain rail car lease contracts, effective September 2020, resulting in significant savings for monthly lease payments and a reduction to Source's total lease obligations outstanding;
- realized gross margin of $7.0 million and Adjusted Gross Margin(1) of $17.3 million;
- realized Adjusted EBITDA(1) of $13.0 million;
- reduced net loss for the three months ended September 30, 2020 to $7.9 million, or $(0.13) per share; and
- announced a proposed Recapitalization Transaction (as defined below) subsequent to quarter end, which will provide a stronger long-term capital structure for Source. This capital structure will enhance liquidity and

increase financial flexibility, allowing Source to withstand industry volatility while still building on its position as the largest frac sand provider in the WCSB.

Note:
(1) Adjusted EBITDA and Adjusted Gross Margin (including on a per MT basis) are not defined under IFRS, refer to 'Non-IFRS Measures' below.

Results Overview

($000's, except MT and per unit amounts)	Three months ended September 30, **2020**	2019	Nine months ended September 30, **2020**	2019
Sand volumes (MT)[1]	**609,469**	550,762	**1,494,166**	1,754,018
Sand revenue	**65,240**	67,639	**161,085**	223,465
Wellsite solutions	**12,636**	10,999	**27,062**	36,973
Terminal services	**669**	1,200	**2,762**	3,874
Sales	**78,545**	79,838	**190,909**	264,312
Cost of sales	**61,242**	61,158	**150,383**	201,633
Cost of sales – depreciation and depletion	**10,264**	10,936	**26,935**	35,692
Cost of sales	**71,506**	72,094	**177,318**	237,325
Gross margin	**7,039**	7,744	**13,591**	26,987
Operating expense	**2,753**	4,753	**9,287**	15,287
General & administrative expense[2]	**2,220**	2,398	**8,176**	9,535
Depreciation	**3,158**	3,875	**11,213**	12,192
Loss from operations	**(1,092)**	(3,282)	**(15,085)**	(10,027)
Other expense (income):				
Finance expense	**7,651**	7,230	**21,942**	20,952
Share-based compensation expense (recovery)	**(22)**	(113)	**(91)**	404
Loss on asset disposal	**(155)**	80	**(150)**	153
Gain on derivative liability	**—**	51	**—**	(1,183)
Other income	**(127)**	(156)	**(1,853)**	(599)
Other expense[3]	**66**	7,780	**186**	21,708
Impairment expense	**—**	61,215	**143,656**	61,215
Foreign exchange loss (gain)[4]	**(562)**	(362)	**(644)**	(984)
Total other expense	**6,851**	75,725	**163,046**	101,666
Loss before income taxes	**(7,943)**	(79,007)	**(178,131)**	(111,693)
Current income tax recovery	**—**	—	**—**	—
Deferred income tax expense (recovery)	**—**	(18,020)	**31,350**	(24,357)
Net loss	**(7,943)**	(60,987)	**(209,481)**	(87,336)
Net loss per share ($/share)	**(0.13)**	(1.01)	**(3.47)**	(1.42)
Diluted net loss per share ($/share)	**(0.13)**	(1.01)	**(3.47)**	(1.42)
Adjusted EBITDA[5]	**13,019**	12,047	**25,560**	39,440
Sand revenue sales/MT	**107.04**	122.81	**107.81**	127.40

	September 30, 2020	December 31, 2019
Total assets	**289,278**	496,665
Total non-current financial liabilities	**223,824**	229,930

Notes:
(1) One MT is approximately equal to 1.102 short tons.
(2) Includes write-off of $1.6 million for receivables deemed uncollectible, refer to 'Operating and General & Administrative Expense' below.
(3) Reflects costs associated with the Fox Creek Incident, see below.
(4) The average Canadian to US dollar exchange rate for the three and nine months ended September 30, 2020 was $0.7507 and $0.7385, respectively (2019 - $0.7573 and $0.7523, respectively).
(5) Adjusted EBITDA is not defined under IFRS, refer to 'Non-IFRS Measures' below.

Results for the third quarter of 2020 reflect a rebound in activity levels in the WCSB, favorably impacting sand sales volumes which increased by 11% compared to the third quarter of 2019. While higher volumes were achieved, sand revenue and total sales revenue were lower by $2.4 million and $1.3 million, respectively, for the third quarter of 2020 compared to the same period last year, due to lower realized sand prices. Wellsite solutions revenue for the third quarter of 2020 was also favorably impacted by the increase in activity levels, with higher trucking revenue and higher Sahara-related revenue compared to the third quarter of 2019.

Cost of sales, excluding depreciation and depletion, continues to be favorably impacted by previously implemented cost savings initiatives and production efficiencies. Reductions in cost of sales have been further impacted by ongoing optimization efforts related to logistics costs.

With the onset of COVID-19, in the second quarter of 2020 Source took immediate steps to ensure the safety of its employees and customers, and implemented a COVID-19 program to protect the health and well-being of employees. In order to further mitigate the impact of the operating environment, Source implemented operational cost reductions and other measures which continued into the third quarter and will continue for the balance of 2020, including the following:

- reduced staff levels and hours of operations;
- reduced Board (as defined below), executive and salaried employee compensation and benefits;
- eliminated all discretionary expenditures;
- reduced capital expenditures;
- negotiated deferral of interest payment obligation on the Notes (as defined below);
- received proceeds from the US Small Business Administration's Paycheck Protection Program (the "US PPP Loan"); and
- received proceeds from the Canadian Emergency Wage Subsidy ("CEWS") program.

In addition to the initiatives noted above, Source also worked closely with certain rail car lease vendors to negotiate more favorable long-term contracts. Source has finalized these negotiations, effective September 2020, resulting in the execution of amended rail car lease contracts which significantly reduce ongoing monthly lease payments and lowered Source's long-term obligations for these leases.

Gross Margin

	Three months ended September 30,		**Nine months ended September 30,**	
($000's, except MT and per unit amounts)	**2020**	2019	**2020**	2019
Gross margin	**$7,039**	$7,744	**$13,591**	$26,987
Cost of sales – depreciation and depletion	**10,264**	10,936	**26,935**	35,692
Adjusted Gross Margin(1)	**17,303**	18,680	**40,526**	62,679
Gross margin/MT	**$11.55**	$14.06	**$9.10**	$15.39
Adjusted Gross Margin/MT(1)	**$28.39**	$33.92	**$27.12**	$35.73
Percentage of mine gate sand volumes	**2%**	—%	**1%**	—%
Percentage of sand volumes sold in the WCSB	**98%**	100%	**99%**	100%
Sales mix impact of mine gate sales/MT	**$0.19**	$—	**$0.03**	$—

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

Gross margin and Adjusted Gross Margin decreased by $0.7 million and $1.4 million, respectively, compared to the third quarter of 2019. The reductions were attributed to lower pricing realized, partially offset by the aggressive cost reduction initiatives implemented, as discussed above, as well as logistics efficiencies achieved.

Compared to the prior year's third quarter, operating and general and administrative expenses for the three months ended September 30, 2020 were lower by $2.2 million, or 30%. Workforce optimization efforts implemented in 2019 as well as cost control measures undertaken in response to COVID-19, as discussed below, drove further reductions in people costs. Operating and general and administrative expenses were also favorably impacted by the receipt of proceeds from the CEWS program of $0.5 million in the quarter.

For the three months ended September 30, 2020, Adjusted EBITDA was $13.0 million, $1.0 million higher than the $12.0 million of Adjusted EBITDA generated in the three months ended September 30, 2019.

Business Outlook

While Source's results for the third quarter were encouraging, the rebound in economic activity remains uncertain as recent surges in the number of active COVID-19 cases raises the question of a potential second wave of the virus, further emphasizing a slow and gradual recovery. The Company expects lower revenue and profitability for the remainder of 2020 and the potential for continued volatility in industry activity into 2021.

Source cannot predict the extent of the impact COVID-19 may have on energy demand, or how the Organization of the Petroleum Exporting Countries will react to those changes in demand and how those events could impact the Company's operations. Source cannot reasonably estimate the period of time that adverse business conditions will persist, the impact they will have on the Company's business, liquidity, consolidated results of operations and consolidated financial condition, or the pace of any subsequent recovery.

Beyond 2020, we continue to remain optimistic about the longer-term industry prospects, including increased demand for WCSB natural gas driven by LNG, coal to natural gas conversions and increased gas pipeline capacity. In addition, analysis of oil pipeline egress capacity and the potential for additional hydrocarbon shipments by rail continue to support the Company's expectation that activity levels should substantially increase in the coming years.

Source has seen exploration and production ("E&P") companies drive additional efficiencies in their completion programs by completing fracs over much shorter periods of time, requiring larger volumes of frac sand. Source's terminal network and logistics capabilities have become a key component in the success of these accelerated frac programs, further enhanced by the delivery capability of the Sahara units. Source is ideally positioned to serve the increase in demand for frac sand and logistics services as activity levels rebound.

Source continues to focus on improving logistics for other items needed at the wellsite, in response to customer requests to expand its service offerings, and continues to develop opportunities to further utilize its existing Western Canadian terminals to provide additional diversification of its business. Over the longer-term, Source anticipates that these new terminal services will be a meaningful part of its business.

Proposed Recapitalization Transaction

The persistent challenges faced by the Western Canadian oil and gas industry have been substantially exacerbated by the global economic slowdown resulting from COVID-19 (refer to 'COVID-19 and Future Operations' below). Source's operating environment has been materially impacted by these events and the collapse of commodity prices. While Source has an industry-leading position as the largest frac sand provider in the WCSB, it is not immune from the effects of these unprecedented circumstances.

In light of these circumstances, the Company, under the supervision of an independent committee (the "Independent Committee") of independent members of our board of directors (the "Board"), has undertaken a comprehensive process to evaluate all reasonably available alternatives to access additional liquidity and improve the Company's capital structure. On October 7, 2020 Source announced a proposed recapitalization transaction (the "Recapitalization Transaction"), designed to provide the Company with a stronger, long-term capital structure and provide enhanced liquidity and financial flexibility. The transaction will, among other things:

- address the maturity and obligations (including all accrued and unpaid interest) under the Notes (as defined below) through an exchange of the Notes for a combination of new senior secured first lien notes due March 15, 2025 (the "New Secured Notes"), resulting in a $32.7 million decrease of the principal amount and the issuance of new common shares of Source, constituting approximately 62.5% of the common shares outstanding on a fully diluted basis;
- enable Source to access new funding under a $20.0 million term loan facility (the "BDC Facility") from Business Development Bank of Canada, with participation from the Company's existing lending syndicate;
- provide enhanced liquidity and financial flexibility as a result of the terms of the New Secured Notes and the BDC Facility, which enable the Company to pay interest in kind, rather than in cash, on the New Secured Notes for all quarterly interest payments up to and including February 15, 2022 and on the BDC Facility for all interest payments during its first 12 months;
- enable Source to obtain the support of its lending syndicate through an amendment to Source's revolving Credit Facility (as defined below) providing the Company with an extended maturity date, ongoing financial flexibility and access to liquidity under the amended Credit Facility; and
- result in existing shareholders retaining approximately 37.5% of the outstanding common shares on a fully-diluted basis following completion of the Recapitalization Transaction, thereby allowing shareholders to participate in the anticipated future growth of Source's business as market conditions improve in the WCSB.

The Recapitalization Transaction is to be implemented by way of a plan of arrangement (the "Plan of Arrangement") pursuant to section 192 of the Canada Business Corporations Act (the "CBCA"). Completion of the Recapitalization Transaction is subject to, among other things, approval by the requisite majorities of noteholders and shareholders, as well as by the Court of Queen's Bench of Alberta (the "Court"). To date, Source has entered into support agreements with (i) noteholders holding approximately 74% of the principal amount of the Notes, and (ii) shareholders holding, directly or indirectly, 45% of the Common Shares, who have agreed, among other things and subject to the terms and conditions of the applicable support agreements, to vote in favour of the Recapitalization Transaction.

On October 26, 2020, the Court issued an interim order (the "Interim Order") authorizing Source to call and conduct meetings of its noteholders and shareholders to vote upon the Plan of Arrangement to implement the Recapitalization Transaction. As all obligations (including unpaid interest) under the Notes will be addressed pursuant to the Plan of Arrangement, Source does not intend to pay the June 15, 2020 interest payment on the Notes in cash when the deferral period ends on October 31, 2020. The Interim Order contains a stay of proceedings preventing any person from exercising any rights or remedies as a result of the non-payment when due of any interest or other amounts payable under the Notes. The Company is working to complete the Recapitalization Transaction prior to the end of 2020.

The Independent Committee and the Board unanimously determined that the proposed Recapitalization Transaction represents the best available option to address the current liquidity challenges facing the Company, preserves value for all stakeholders and provides Source with a stronger long-term capital structure that will allow it to capitalize on its industry-leading position when market and industry conditions begin to improve. The Independent Committee and the Board therefore have unanimously approved the Recapitalization Transaction.

COVID-19 and Future Operations

In March 2020, COVID-19 was declared a global pandemic by the World Health Organization. Measures enacted to prevent the spread of the virus have resulted in global business disruption with significant economic repercussions. At the end of the first quarter of 2020, as a result of the weakening economic climate and demand for crude oil, the Company carried out an assessment of the recoverable value of its operations, resulting in an impairment loss recognized in the first quarter of 2020. For the three months ended September 30, 2020, the Company determined that no additional indicators of impairment were present and concluded no further impairment analysis was required.

In May 2020, as a result of the weakened operating climate, the Company obtained covenant relief from its banking syndicate, including the waiver of the application of the fixed charge coverage ratio from May 31, 2020 and subsequently through October 30, 2020. In June 2020, Source entered into a Support and Interest Deferral Agreement (as amended, the “Deferral Agreement”) with noteholders holding approximately 72% of Source’s Notes. Under the Deferral Agreement, the June 15, 2020 interest payment on the Notes has been deferred until October 31, 2020. The Company recently announced the proposed Recapitalization Transaction and the Interim Order, as outlined above. However, there can be no assurance that the Recapitalization Transaction will be completed, and therefore there is material uncertainty that may cast doubt on the Company’s ability to continue as a going concern.

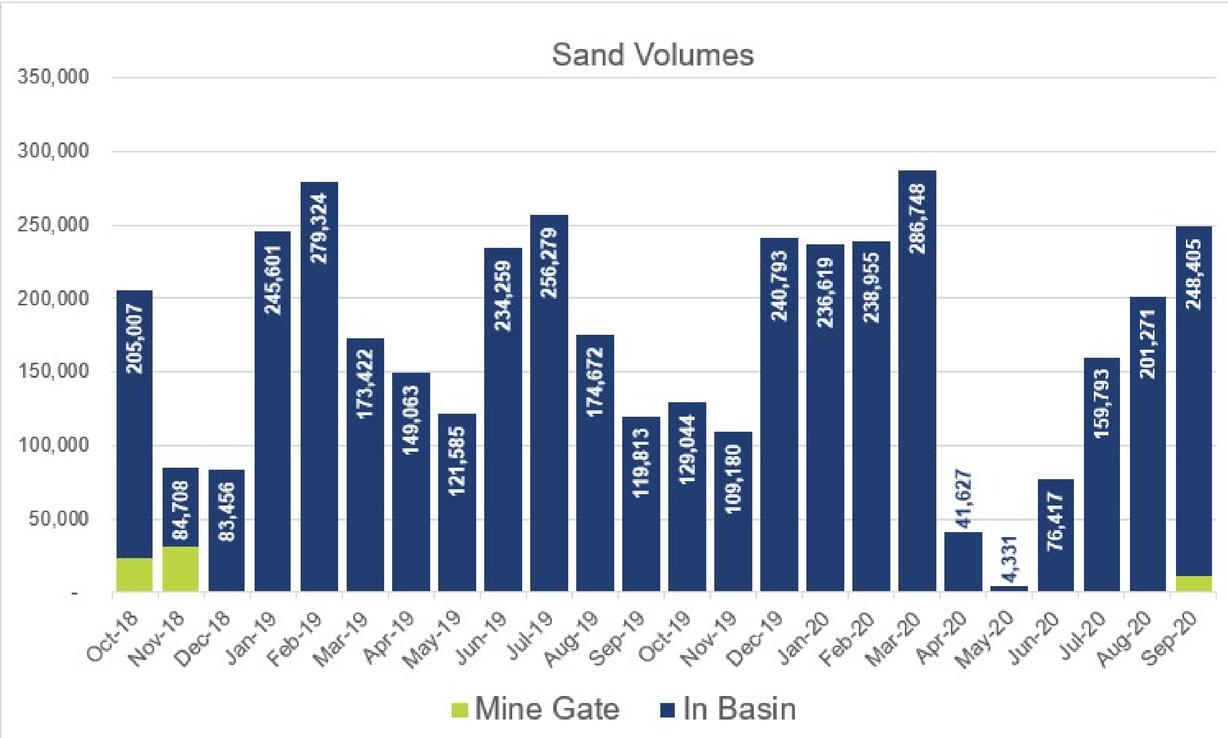
Source’s condensed consolidated interim financial statements have been prepared on a going concern basis and do not reflect adjustments and classifications of assets, liabilities, revenues and expenses which would be necessary if the Company were unable to continue as a going concern. Such adjustments could be material.

Review of Operations

Sales

	Three months ended September 30,		**Nine months ended September 30,**	
($000’s, except MT and per unit amounts)	**2020**	2019	**2020**	2019
Sand volumes (MT)	**609,469**	550,762	**1,494,166**	1,754,018
Sand revenue	**65,240**	67,639	**161,085**	223,465
Wellsite solutions	**12,636**	10,999	**27,062**	36,973
Terminal services	**669**	1,200	**2,762**	3,874
Sales	**78,545**	79,838	**190,909**	264,312

Total revenue for the three months ended September 30, 2020 was $78.5 million, a decrease of $1.3 million or 2% compared with total revenue of $79.8 million for the three months ended September 30, 2019. A significant increase in activity levels, as customers restarted capital spending in response to a recovery in the price of commodities, favorably impacted sand volumes and wellsite solutions revenue. Higher sand sales volumes achieved were offset by lower average realized sand pricing in the quarter.



Sand revenue is predominately comprised of sand sales into the WCSB at a Source terminal or to a customer wellsite utilizing Source's integrated logistics business model. This is referred to as "In Basin" sales and it represents Source's core business.

In prior years, sand revenue also included mine gate sand sales, which included the sale of products that are in lower demand in the WCSB and sold at the mine sites in the US. Mine gate sand sales are undertaken to maximize production efficiencies and sand volumes but are not considered Source's core business and are typically at a lower sales price than In Basin sales and provide a comparatively lower margin per MT sold.

Wellsite solutions revenue is comprised of revenue from "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 increasing operational efficiencies. Source also provides terminal services for certain well-completion products that aren't produced by Source. These products primarily consist of hydrochloric acid, chemicals and resin-coated proppants. The magnitude of terminal services revenues realized by Source generally follows completion activity trends in the WCSB.

Sand Revenue

Source's sand revenue for the three months ended September 30, 2020 was $65.2 million, a decrease of $2.4 million, or 4%, from the same period in 2019 and an increase of $52.4 million from the second quarter of 2020. For the nine months ended September 30, 2020, sand revenue was $161.1 million, a decrease of $62.4 million, or 28%, compared to the same period last year.

As discussed above, revenue for the quarter was favorably impacted by a return to activity in the WCSB as customers took advantage of stabilized commodity pricing by deploying capital in advance of the end of the year, significantly improving volumes and revenue relative to the second quarter of 2020. When compared to the same quarter of 2019, higher sand volumes were offset by lower realized average sand prices, as pricing pressure continued to impact results relative to the same period last year. On a year-to-date basis, sand sales volumes and overall revenue were materially impacted by the onset of COVID-19, as discussed above, compared to the nine months ended September 30, 2019.

Wellsite Solutions and Terminal Services

Wellsite solutions revenue was $12.6 million for the three months ended September 30, 2020, an increase of $1.6 million, or 15%, compared with the same period in 2019 and an increase of $10.3 million compared to the second quarter of 2020. For the nine months ended September 30, 2020, wellsite solutions revenue decreased by $9.9 million, or 27%, compared with the same period in 2019.

Wellsite solutions revenue in the third quarter was favorably impacted by the improvement in sand sales volumes, relative to the same quarter last year and the prior quarter, as trucking revenue and Sahara-related revenues fluctuated with activity levels in the basin. Higher trucking and Sahara-related revenue for the three months ended September 30, 2020 resulted from the reinstatement of completion activities, as noted above. On a year-to-date basis, revenue from wellsite solutions was materially impacted by the onset of COVID-19, resulting in significantly lower volumes and lower utilization days, as discussed above, compared to the nine months ended September 30, 2019.

Terminal services revenue was $0.7 million for the three months ended September 30, 2020, a decrease of $0.5 million, or 44%, compared with the same period in 2019 and a decrease of $0.1 million, or 12%, compared to the second quarter of 2020. For the nine months ended September 30, 2020, terminal services revenue decreased by $1.1 million, or 29%, compared with the same period in 2019.

Terminal services revenue was impacted by lower proppant storage revenue, as contractual rates stepped down in the fourth quarter of 2019, as well as a decrease in hydrochloric acid transloading revenue, relative to both the second quarter of 2020, the same period last year and on a year-to-date basis. These decreases were partially offset by revenue generated from diversification initiatives launched in 2019 of $0.8 million for the nine months ended September 30, 2020.

Cost of Sales

	Three months ended September 30,		**Nine months ended September 30,**	
($000's)	**2020**	2019	**2020**	2019
Direct materials	**50,448**	50,873	**124,863**	165,450
People costs	**1,672**	2,855	**5,343**	8,584
Equipment costs	**427**	564	**1,482**	1,652
Transportation costs	**8,649**	6,763	**18,020**	25,565
Facility costs	**46**	103	**675**	382
Cost of sales	**61,242**	61,158	**150,383**	201,633
Cost of sales - depreciation and depletion	**10,264**	10,936	**26,935**	35,692

Cost of sales, excluding depreciation and depletion, was $61.2 million for the three months ended September 30, 2020, an increase of $0.1 million, compared to the three months ended September 30, 2019, and an increase of $48.8 million, compared to the second quarter of 2020. For the nine months ended September 30, 2020, cost of sales, excluding depreciation, was $150.4 million, a decrease of $51.3 million, or 25%, compared to the same period last year. The year-over-year reduction in cost of sales, excluding depreciation and depletion, is primarily attributable to the impact of COVID-19, as previously referenced.

As discussed above, the third quarter witnessed a resurgence in activity levels, compared to the second quarter of 2020, which was significantly impacted by the weak economic climate attributed to the effects of COVID-19. Despite the increase in activity levels, Source was able to maintain operational cost reductions implemented last year and further expanded in 2020 in response to COVID-19, including optimizing production from plants resulting in savings associated with people costs. These efforts resulted in cost of sales, excluding depreciation, that was flat compared to the third quarter of 2019, while sand volumes sold increased 11%.

Proceeds from the CEWS program of $0.6 million and $1.2 million were received in the three and nine months ended September 30, 2020, respectively, also contributing to the reduction in cost of sales. Source also applied for and received proceeds of US$2.1 million from the US PPP Loan in the second quarter of 2020. These funds were used to help finance operating wages in the US. Source expects to have substantially all of this loan forgiven in subsequent quarters, at which time the benefits realized will further reduce cost of sales.

Significant components of cost of sales are mainly US dollar denominated including sand processing and rail freight and are therefore subject to exchange rate fluctuations. For the three and nine months ended September 30, 2020, a weakening of the Canadian dollar on US dollar denominated components of sales of 0.9% and 1.9%, respectively, partially offset the above-noted cost of sales reductions. For the three months ended September 30, 2020, a strengthening of the Canadian dollar on US dollar denominated components of sales of 3.8%, compared to the second quarter of 2020, partially offset the above-noted cost of sales increase.

Gross Margin

($000's, except MT and per unit amounts)	Three months ended September 30, **2020**	2019	Nine months ended September 30, **2020**	2019
Gross margin	**7,039**	7,744	**13,591**	26,987
Cost of sales — depreciation and depletion	**10,264**	10,936	**26,935**	35,692
Adjusted Gross Margin(1)	**17,303**	18,680	**40,526**	62,679
Gross margin %	**9.0%**	9.7%	**7.1%**	10.2%
Gross margin/MT	**$11.55**	$14.06	**$9.10**	$15.39
Adjusted Gross Margin %(1)	**22.0%**	23.4%	**21.2%**	23.7%
Adjusted Gross Margin/MT(1)	**$28.39**	$33.92	**$27.12**	$35.73

Note:
(1) Adjusted Gross Margin is not defined under IFRS, refer to 'Non-IFRS Measures' below.

Adjusted Gross Margin and gross margin decreased by $1.4 million and $0.7 million, respectively, in the third quarter of 2020 compared to the third quarter of 2019. Higher sand volumes realized in the quarter was impacted by lower average realized prices, partially offset by the ongoing cost reduction and production efficiencies achieved, as noted above.

Adjusted Gross Margin and gross margin decreased by $22.2 million and $13.4 million, respectively, for the nine months ended September 30, 2020, compared to the same period in 2019. The decrease was mainly attributed to the material impact of COVID-19 on Source's operations in the second quarter of 2020, partly offset by the cost reduction initiatives implemented in 2019, and further enhanced this year, as a result of the depressed economic and operating climate.

Adjusted Gross Margin and gross margin increased by $13.9 million and $6.9 million, respectively, for the third quarter of 2020, compared to the second quarter of 2020. The improvement was due to higher activity levels realized in the quarter, as customers reinstated capital spending and projects resumed, as well as the benefit realized from the implementation of additional COVID-19-related cost reduction measures, as noted above.

Operating and General & Administrative Expense

	Three months ended September 30,				Nine months ended September 30,			
	2020		2019		**2020**		2019	
($000's)	**OPEX**	**G&A**	OPEX	G&A	**OPEX**	**G&A**	OPEX	G&A
People	**1,102**	**1,159**	1,769	1,457	**3,832**	**3,924**	5,904	6,063
Equipment	**125**	**—**	270	16	**778**	**1**	1,172	16
Facility	**289**	**25**	787	23	**978**	**50**	2,356	155
Selling and administrative	**1,237**	**1,036**	1,927	902	**3,699**	**4,201**	5,855	3,301
Operating and General & Administrative Expense	**2,753**	**2,220**	4,753	2,398	**9,287**	**8,176**	15,287	9,535

For the third quarter of 2020, total operating and general and administrative expenses were $5.0 million, a reduction of $2.2 million or 30% from the third quarter of 2019. Operating expense was $2.8 million, a decrease of $2.0 million from the same period last year. The decrease was primarily attributable to workforce optimization including lower variable incentive compensation and cost savings initiatives implemented in mid-2019, resulting in lower people and selling costs. In the second quarter of 2020, further cost reduction initiatives were implemented in response to the impact of COVID-19, and proceeds of $0.3 million were received from the CEWS program, also contributing to the reduction in operating expense.

General and administrative expense for the three months ended September 30, 2020 was $2.2 million, a decrease of $0.2 million compared to the same period in 2019. The decrease was driven in part by benefits achieved from cost savings initiatives and workforce optimization changes implemented last year, as noted above, as well as additional cost reduction initiatives launched in response to the current operating environment. Proceeds of $0.2 million were received from the CEWS program, further contributing to the quarter-over-quarter savings achieved. These reductions were partially offset by higher fees for professional services incurred.

For the nine months ended September 30, 2020, total operating and general and administrative expense was $17.5 million, a reduction of $7.4 million or 30% from the nine months ended September 30, 2019. Operating expense was $9.3 million, a decrease of $6.0 million from the same period last year. General and administrative expense for the nine months ended September 30, 2020 was $8.2 million, a decrease of $1.4 million compared to the same period in 2019. The changes in operating and general and administrative expense were due to previously implemented cost reduction initiatives, as well as additional measures taken to mitigate the impact of the reduction in activity levels, as noted above. These savings were partially offset by the write-off of $1.6 million of uncollectible receivables in the second quarter of 2020, attributed to a pressure pumping customer who recently filed for creditor protection, a direct result of the impact of COVID-19 and volatile commodity markets on its operations.

For the three months ended September 30, 2020, total operating and general and administrative expense was $0.7 million lower than the second quarter of 2020. Operating expense was $0.5 million higher than prior quarter, as a result of increased activity levels in the quarter, and general and administrative expense decreased by $1.2 million. The improvement in general and administrative expense was primarily due to the expense related to the write-off of accounts receivable in the second quarter, as described above, offset in part by higher professional fees incurred, as noted above.

Depreciation

Depreciation expense decreased in the third quarter of 2020, compared to the same quarter last year and the second quarter of 2020, by $0.7 million and $0.6 million, respectively. Depreciation expense decreased by $1.0 million for the nine months ended September 30, 2020, compared to the same period last year. The reductions relative to the prior year periods were due to depreciation on a lower asset base, as a result of impairment recognized in the third quarter of 2019 and the first quarter of 2020. The decrease relative to the second quarter was attributed to lower depreciation on a lower right-of-use asset base, as a result of the modification of renegotiated lease contracts executed in the quarter.

Finance Expense

Finance expense increased by $0.4 million to $7.7 million in the third quarter of 2020, compared with the same period in 2019, and $0.6 million compared with the second quarter of 2020, primarily due to higher accretion expense incurred, an increase in other miscellaneous finance fees and higher interest rates being charged on the Credit Facility. These increases were partially offset by lower interest expense incurred for lease liabilities due to rail and equipment fleet efficiencies achieved, as well as the renegotiation of certain rail car and equipment lease contracts executed in the third quarter of 2020. On a year-to-date basis, finance expense increased by $1.0 million, compared to the same period last year, primarily due to higher draws on the Credit Facility during the first nine months of 2020, compared to last year, as well as higher accretion expense, other miscellaneous finance fees and higher interest rates for the Credit Facility, offset in part by lower interest for lease liabilities, as noted above.

Share-based Compensation

For the three months ended September 30, 2020, share-based compensation expense (recovery) remained relatively unchanged compared to the same period in 2019 and the second quarter of 2020. In the first nine months of 2020, Source recognized a $0.1 million recovery compared to an expense of $0.4 million for the same period last year. The change is primarily due to the movement in Source's share price relative to last year. Share-based compensation expense is associated with the deferred share units ("DSUs"), restricted share units ("RSUs"), performance share units ("PSUs") and accrued expense related to the stock options ("Options").

During the first quarter of 2020 the remaining 516,169 Options expired, leaving no Options outstanding as at September 30, 2020.

Loss (Gain) on Derivative Liability

Source recorded no change for the value of the derivative liability for the three and nine months ended September 30, 2020, compared to a $0.1 million loss and $1.2 million gain, respectively, for the three and nine months ended September 30, 2019. 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 foreign exchange rate collars. The collars were wound up in January 2020.

Other (Income) Expense

For the three months ended September 30, 2020, other income remained unchanged compared to the same period last year, and increased by $1.3 million on a year-over-year basis. The increase was due to the recovery of certain sales and use taxes incurred at the US operating facilities. For the three months ended September 30, 2020, other income decreased by $0.3 million from the second quarter of 2020 as a result of adjustments made to amounts recoverable for sales and use taxes, as noted above.

Other expense decreased by $7.7 million and $21.5 million, respectively, for the three and nine months ended September 30, 2020 compared to the same periods last year, primarily due to the $13.9 million write-off of damaged assets and other expenses related to the May 2019 incident at Fox Creek (the "Fox Creek Incident"). For additional information related to the Fox Creek Incident refer to the audited condensed consolidated annual financial statements for the year ended December 31, 2019.

Impairment Expense

Impairment expense for the three and nine months ended September 30, 2020 was $nil and $143.7 million, respectively, compared to $61.2 million for the same periods last year. Refer to 'COVID-19 and Future Operations' above, and Note 8 of the Company's unaudited condensed consolidated interim financial statements for the three and nine months ended September 30, 2020 for additional detail related to this impairment.

Income Tax

Source recorded a tax expense of $nil for the three months ended September 30, 2020, compared to a recovery of $18.0 million for the same period in 2019 and $nil for the second quarter of 2020. For the nine months ended September 30, 2020, Source recorded an income tax expense of $31.4 million, compared to a recovery of $24.4 million for the same period last year. The increase in income tax expense is due to the reversal of the cumulative deferred tax asset recognized in the first quarter of 2020.

Summary of Quarterly Results

($000's, except MT and per unit amounts)	2018	2019				2020		
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Sand volumes (MT)	*373,171*	*698,347*	*504,907*	*550,762*	*479,017*	*762,322*	*122,375*	*609,469*
Sand revenue	45,459	91,149	64,677	67,639	58,401	83,019	12,826	65,240
Wellsite solutions	7,299	15,480	10,494	10,999	9,235	12,113	2,313	12,636
Terminal services	1,307	1,504	1,172	1,200	1,006	1,331	762	669
Sales	54,065	108,133	76,343	79,838	68,642	96,463	15,901	78,545
Cost of sales	47,109	83,794	56,681	61,158	51,669	76,656	12,485	61,242
Cost of sales depreciation	3,253	13,984	10,772	10,936	6,351	13,430	3,241	10,264
Cost of sales	50,362	97,778	67,453	72,094	58,020	90,086	15,726	71,506
Gross margin	3,703	10,355	8,890	7,744	10,622	6,377	175	7,039
Operating expenses	7,230	5,182	5,352	4,753	5,423	4,297	2,237	2,753
General & administrative expenses	3,225	4,764	2,373	2,398	2,712	2,557	3,399	2,220
Depreciation	3,083	4,306	4,011	3,875	4,020	4,257	3,798	3,158
Income (loss) from operations	(9,835)	(3,897)	(2,846)	(3,282)	(1,533)	(4,734)	(9,259)	(1,092)
Other expense (income):								
Finance expense	5,956	6,870	6,852	7,230	7,108	7,246	7,045	7,651
Share-based compensation expense (recovery)	(372)	924	(407)	(113)	(201)	(96)	27	(22)
Loss (gain) on asset disposal	(347)	—	73	80	8	5	—	(155)
Loss (gain) on derivative liability	368	(767)	(466)	51	(144)	—	—	—
Other income	(142)	(323)	(120)	(156)	(328)	(1,344)	(382)	(127)
Other expense	—	—	13,929	7,780	(5,755)	108	12	66
Impairment expense	—	—	—	61,215	—	143,656	—	—
Foreign exchange loss (gain)	(127)	(97)	(525)	(362)	(18)	(312)	230	(562)
Total other expense	5,336	6,607	19,336	75,725	670	149,263	6,932	6,851
Income (loss) before income taxes	(15,171)	(10,504)	(22,182)	(79,007)	(2,203)	(153,997)	(16,191)	(7,943)
Income taxes expense (recovery)	(366)	(3,182)	(3,155)	(18,020)	416	31,350	—	—
Net income (loss)	(14,805)	(7,322)	(19,027)	(60,987)	(2,619)	(185,347)	(16,191)	(7,943)
Net income (loss) per share ($/share)	(0.22)	(0.12)	(0.31)	(1.01)	(0.05)	(3.08)	(0.26)	(0.13)
Diluted net income (loss) per share ($/share)	(0.22)	(0.12)	(0.31)	(1.01)	(0.05)	(3.08)	(0.26)	(0.13)
Net income (loss)	(14,805)	(7,322)	(19,027)	(60,987)	(2,619)	(185,347)	(16,191)	(7,943)
Interest	4,798	5,896	5,920	6,255	6,097	6,175	5,890	6,373
Income taxes	(366)	(3,182)	(3,155)	(18,020)	416	31,350	—	—
Depreciation	3,083	4,306	4,011	3,875	4,020	4,257	3,798	3,158
Cost of sales depreciation	3,253	13,984	10,772	10,936	6,351	13,430	3,241	10,264
Impairment expense	—	—	—	61,215	—	143,656	—	—
EBITDA(1)	(4,037)	13,682	(1,479)	3,274	14,265	13,521	(3,262)	11,852
Add:								
Loss (gain) on asset disposal	(347)	—	73	80	8	5	—	(155)
Finance expense	1,158	974	932	975	1,011	1,071	1,155	1,278
Loss (gain) on derivative liability	368	(767)	(466)	51	(144)	—	—	—
Share-based compensation expense (recovery)	(372)	924	(407)	(113)	(201)	(96)	27	(22)
Other expense	—	—	13,929	7,780	(5,755)	108	12	66
Adjusted EBITDA(1)	(3,230)	14,813	12,582	12,047	9,184	14,609	(2,068)	13,019
Sand revenue sales/MT	121.82	130.52	128.10	122.81	121.92	108.90	104.81	107.04
Gross margin	3,703	10,355	8,890	7,744	10,622	6,377	175	7,039
Cost of sales depreciation	3,253	13,984	10,772	10,936	6,351	13,430	3,241	10,264
Adjusted Gross Margin(1)	6,956	24,339	19,662	18,680	16,973	19,807	3,416	17,303
Gross margin/MT	9.92	14.83	17.61	14.06	22.17	8.37	1.43	11.55
Adjusted Gross Margin/MT(1)	18.64	34.85	38.94	33.92	35.43	25.98	27.91	28.39

Note:
(1) EBITDA, Adjusted EBITDA and Adjusted Gross Margin are not defined under IFRS, refer to 'Non-IFRS Measures' below.

Source's business is seasonal in nature with the majority of activity normally being in the first and third quarters of the year. Lower activity levels are usually realized in the fourth quarter, as E&P companies evaluate remaining capital spend for the year, and 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 its 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 mines 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.

Liquidity and Capital Resources

Free Cash Flow	**Three months ended September 30,**		**Nine months ended September 30,**	
($000's)	**2020**	2019	**2020**	2019
Cash flows provided by operating activities	**(6,250)**	36,294	**26,320**	45,773
Financing expense paid	**(2,253)**	(2,228)	**(6,814)**	(14,116)
Maintenance and sustaining capital spend	**(137)**	(569)	**(1,961)**	(2,648)
Repayment of finance lease obligations	**(3,640)**	(5,688)	**(12,229)**	(17,999)
Proceeds on contract liabilities, net of satisfaction of performance obligations	**83**	539	**1,452**	1,506
Free Cash Flow [(1)]	**(12,197)**	28,348	**6,768**	12,516

Note:

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

Free Cash Flow for the three months ended September 30, 2020 was negative $12.2 million, compared with $28.3 million for the same period in 2019. Free Cash Flow was unfavorably impacted by higher net changes in non-cash working capital due to the improved sales levels relative to the second quarter of 2020, resulting in a significant increase in accounts receivable balances. Reduced amounts paid for lease obligations favorably impacted Free Cash Flow for the quarter, a result of lease payment holidays and lower payments for rail car leases negotiated in the period.

For the nine months ended September 30, 2020, Source generated Free Cash Flow of $6.8 million compared with $12.5 million for the nine months ended September 30, 2019. Cash flows provided by operating activities were lower than the same period last year due to the impact of COVID-19 on results of operations. A reduction in finance expense paid was partly due to lower interest for the Notes as a result of the Deferral Agreement for the June 15, 2020 interest payment (as outlined above). Source has successfully renegotiated certain long-term lease obligations for rail cars and heavy equipment which also favorably impacted finance expense paid, resulting in lower interest incurred for these lease obligations. Free Cash Flow also benefited from lease payment holidays negotiated through the second and third quarters of 2020, as well as lower expenditures for maintenance and sustaining capital.

Source funded its capital spend in 2020 and 2019 through amounts available under the existing Credit Facility and cash flows from operations. The Free Cash Flow generated on a year-to-date basis in 2020 was used to lower amounts outstanding on the asset backed loan facility ("ABL"), which fluctuates with the movement in working capital balances, as well as funding requirements of the operations of the business.

Source operates in a working capital and capital expenditure intensive industry where capital is required to fund working capital growth and maintenance capital expenditures for the Company. The Company has a banking operating facility, comprised of the ABL and a standby letter of credit facility (collectively, the "Credit Facility"). 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 financial requirements to grow and operate its business operations in the short-term 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. As described above, Source has negotiated a proposed Recapitalization Transaction which, if approved, will provide the Company with a stronger, long-term capital structure including enhanced liquidity and financial flexibility. The availability of any additional future funding beyond that provided by the proposed Recapitalization Transaction will depend on, among other things, operating performance and the current state of the equity and debt capital markets.

Capital expenditures	**Three months ended September 30,**		**Nine months ended September 30,**	
($000's)	**2020**	2019	**2020**	2019
Terminal expansion	**—**	143	**43**	10,063
Wellsite solutions	**249**	26	**670**	4,733
Production expansion	**17**	1,047	**525**	6,021
Overburden removal	**119**	569	**1,203**	2,888
Other	**1**	—	**104**	—
Capital expenditures	**386**	**1,785**	**2,545**	**23,705**

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 third quarter of 2020 were $0.4 million, a decrease of $1.4 million from the third quarter of 2019. Capital expenditures were lower, on a quarter-over-quarter basis, due primarily to the completion of certain terminal and production expansion projects in the prior year. Compared to the second quarter of 2020, capital expenditures were relatively unchanged; however, for the nine months ended September 30, 2020 capital expenditures were $21.2 million lower than the same period in 2019 due to the completion of the Fox Creek terminal expansion and two Sahara units in 2019.

Source's capital management policy is to maintain a strong capital base that optimizes its 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's 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 nine months ended September 30, 2020.

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. Refer to 'COVID-19 and Future Operations' above.

Long-term Debt

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. 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. At September 30, 2020, the principal outstanding on the Notes was $157.7 million (December 31, 2019 - $157.7 million).

In June 2020, as a result of the weakened operating environment and general slowdown of the economy, Source entered into the Deferral Agreement with noteholders holding approximately 72% of Source's Notes. Under the Deferral Agreement, and subsequent amendments, the June 15, 2020 interest payment on the Notes has been deferred until October 31, 2020. To give effect to the deferral, the Deferral Agreement amends the Notes indenture by extending the grace period in respect of the interest payment to October 31, 2020. Refer to 'Proposed Recapitalization Transaction' above.

On June 20, 2019, the $88 million Credit Facility was amended to extend the term for another year to mature on December 8, 2021 and added a US$5 million standby letter of credit that does not affect the facility's borrowing base. 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 and is updated monthly. As of September 30, 2020, $25.7 million was drawn under this facility (December 31, 2019 - $28.7 million). The Credit Facility was also being used to support $16.0 million of letters of credit (December 31, 2019 - $17.5 million) leaving $21.0 million (December 31, 2019 - $18.4 million), or 33%, of available liquidity (December 31, 2019 - 28%). 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 to be measured when Source's excess availability is less than 20% of the lesser of the borrowing base and the operating facility.

In February 2020 an amendment to the ABL was completed, effective January 1, 2020, which included a reduction of the springing fixed charge ratio from 1.25:1 to 1.10:1 for all periods ending on or before December 31, 2020. In May 2020, as a result of the weakened operating environment, as noted above, Source obtained covenant relief from its banking syndicate, including the waiver of the application of the fixed charge coverage ratio from May 31, 2020 through October 30, 2020. Refer to 'Proposed Recapitalization Transaction' above.

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 the 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 September 30, 2020 are $32.2 million (December 31, 2019 - $31.4 million) and $14.5 million (December 31, 2019 - $31.9 million) denominated in foreign currency, respectively. The net effect of each 1% change in foreign exchange would have an impact on net income of $0.2 million for the three months ended September 30, 2020 (three months ended September 30, 2019 - $0.3 million).

Cash and Net Working Capital

As at September 30, 2020, Source had no cash on hand and had senior long-term debt outstanding of $181.1 million, compared to $178.8 million as at December 31, 2019. The increase in senior long-term debt outstanding was due to the accretion on the Notes and proceeds received in respect of the US PPP Loan, partially offset by repayments made on the Credit Facility.

Total current assets less total current liabilities (net working capital) as at September 30, 2020 was $38.1 million, compared to $16.0 million as at June 30, 2020 and $45.6 million as at December 31, 2019. The increase, compared to the prior quarter, was primarily due to an increase in accounts receivable as a result of higher sales volumes and lower lease liabilities resulting from completed lease negotiations, as outlined above. These changes were partially offset by improved activity for the quarter which resulted in lower inventory levels and an increase in accounts payable and accruals as at September 30, 2020. The decrease in net working capital as at September 30, 2020 compared to the December 31, 2019 was due to lower inventory levels and higher accounts payable and accruals, partially offset by the reduction in lease obligations, as noted above.

Contract Liabilities

Source entered into an agreement with one of its customers, effective January 1, 2018, where Source received $14.8 million (US$11.5 million) as a prepayment for future purchases of proppant. In consideration for 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 was also reduced for each MT of sand sold or pumped by the customer. During the nine months ended September 30, 2020, $1.5 million of this obligation was satisfied, with a balance of $1.5 million remaining.

Contractual Obligations

Source has various commitments regarding lease agreements and physical natural gas contracts. The leases expire between October 2020 and March 2032. The financial liabilities on Source's condensed 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)	**Total**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025 and thereafter**
Lease liabilities	47,341	3,919	11,971	8,900	7,100	5,854	9,597
Other commitments	3,163	336	1,249	1,249	329	—	—
Credit Facility(1)	25,668	—	25,668	—	—	—	—
Notes	190,104	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 September 30, 2020 balances and interest rates, and assuming amounts stay outstanding until maturity, estimated total interest expense would be $3.7 million.

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 and nine months ended September 30, 2020 was 59,652,731 (three and nine months ended September 30, 2019 - 59,652,731 and 60,232,907, respectively).

	Three months ended September 30,		**Nine months ended September 30,**	
	2020	2019	**2020**	2019
Common shares outstanding, beginning of period	**59,652,731**	59,652,731	**59,652,731**	60,936,712
Weighted average shares repurchased and canceled under NCIB	—	—	—	(703,805)
Weighted average common shares outstanding, end of period	**59,652,731**	59,652,731	**59,652,731**	60,232,907
Common shares issuable pursuant to conversion option of Class B Shares (1)	—	—	—	—
Weighted average number of diluted common shares outstanding, end of period	**59,652,731**	59,652,731	**59,652,731**	60,232,907

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

As at October 29, 2020, Source had issued and outstanding (i) 60,952,885 common shares and (ii) nil Class B shares. Pursuant to the proposed Recapitalization Transaction, on October 22, 2020, TriWest Capital Management Corp. exchanged all of the outstanding Class B shares into common shares of the Company on a one-for-one basis. Refer to 'Proposed Recapitalization Transaction' above.

Transactions between Related Parties

During the third quarter of 2020 there were no related party transactions.

Proposed Transactions

Source recently announced a proposed Recapitalization Transaction, which the Company intends to implement by way of the Plan of Arrangement under the CBCA subsequent to the date of this MD&A. Refer to 'Proposed

Recapitalization Transaction' above for additional information related to this transaction. The Independent Committee and the Board strongly urge shareholders and noteholders to vote in support of the Recapitalization Transaction.

Beyond the proposed Recapitalization Transaction, Source does not have any proposed transactions 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 September 30, 2020. There were no material weaknesses in the design of the DC&P and the ICFR at September 30, 2020, and no changes in ICFR during the period beginning on January 1, 2020 and ended on September 30, 2020 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.

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 Company's 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 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 it bears interest at market floating rates consistent with market rates for similar debt. Based on the closing market price as of September 30, 2020, the fair value of the Notes was $33.1 million (December 31, 2019 - $76.5 million).

Source has a customer contract that was renegotiated in November 2019. The original contract included foreign exchange rate collars that were adjusted if the daily US dollar to Canadian dollar closing exchange rate fell below $1.25 or exceeded $1.40. The embedded derivative was separated from the contract and accounted for as a derivative asset or liability and was measured at fair value through profit or loss. The fair value of the derivative was 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. The collars were wound up and settled in January 2020.

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	January 2020
USD $1,500	1.25	USD $3,000	1.40	January 2020

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, a 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 were depleted using the unit-of-production method based on indicated and inferred reserves. Depletion was recorded on a per tonne basis as the reserves were 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, Source's 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 circumstance 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.

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) loss (gain) on asset disposal; (c) transaction and professional fees; (d) loss (gain) on derivative liability; (e) gain on settlement of deferred revenue; (f) share-based compensation; and (g) other expense as it relates to the Fox Creek Incident.

EBITDA represents, for the period presented, net income (loss) plus: (a) income taxes; (b) interest expense; (c) cost of sales – depreciation; (d) depreciation; (e) amortization; and (f) impairment, 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 its 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 September 30,		Nine months ended September 30,	
($000's)	**2020**	2019	**2020**	2019
Net income (loss)	**(7,943)**	(60,987)	**(209,481)**	(87,336)
Add:				
Tax expense (recovery)	**—**	(18,020)	**31,350**	(24,357)
Interest expense	**6,373**	6,255	**18,436**	18,071
Cost of sales – depreciation and depletion	**10,264**	10,936	**26,935**	35,692
Depreciation	**3,158**	3,875	**11,213**	12,192
Impairment expense	**—**	61,215	**143,656**	61,215
EBITDA	**11,852**	3,274	**22,109**	15,477
Add:				
Finance expense excluding interest expense	**1,278**	975	**3,506**	2,881
Share-based compensation expense (recovery)	**(22)**	(113)	**(91)**	404
Loss (gain) on asset disposal	**(155)**	80	**(150)**	153
Loss (gain) on derivative liability	**—**	51	**—**	(1,183)
Other expense	**66**	7,780	**186**	21,708
Adjusted EBITDA	**13,019**	12,047	**25,560**	39,440

Reconciliation of Gross Margin to Adjusted Gross Margin

	Three months ended September 30,		Nine months ended September 30,	
($000's)	**2020**	2019	**2020**	2019
Gross margin	**7,039**	7,744	**13,591**	26,987
Cost of sales – depreciation and depletion	**10,264**	10,936	**26,935**	35,692
Adjusted Gross Margin	**17,303**	18,680	**40,526**	62,679

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: the Recapitalization Transaction and the capital structure of Source after such Recapitalization Transaction is completed; our continued optimism for longer term industry prospects and increased demand for LNG on WCSB activity levels; anticipated improvements in pipeline egress and transportation capacity, coal to natural gas power generation conversions and the potential for additional hydrocarbon shipments by rail; outlook for operations and sales volumes; expectations respecting future conditions; revenue and profitability; industry activity levels; the unknown impact of COVID-19 on the global economy and the effect it may continue to have on the Company's business, liquidity, operations and financial condition and the pace of any subsequent recovery; expectations regarding market share; industry conditions pertaining to the frac sand industry; the benefits that Source's "last mile" services provide to customers; expectations regarding customer relationships and counterparty risk; the anticipated effect of terminal services on Source's business; expectations regarding funding for future working capital and capital expenditures; Source's planned cash outflows relating to lease commitments and financial liabilities; the ability to secure future funding; expectations on Source's ability to meet their capital needs; uncertainty regarding Source's ability to continue as a going concern if the Recapitalization Transaction is not completed; expectations regarding fluctuations in foreign currency; expectations regarding the severity and outcome of legal claims and proceedings; expectations regarding the impact of climate change; risks associated with information systems and cyber security; and operational risks.

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: our ability to complete the Recapitalization Transaction, the ability to obtain the third party consents required to complete same and the timeframe in which such consents will be obtained; 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, Source's rail car fleet and the accessibility of additional 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 inability to obtain the consents required to complete the Recapitalization Transaction, and, thus, our inability to complete the Recapitalization Transaction; 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 impact of climate change risk; 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; the use and suitability of Source's accounting estimates and judgments; and the impact of information systems and cyber security breaches.

Although Source has attempted to identify important factors that could cause actual actions, events or results to differ materially from those described in the 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 have been approved by the Company's management as at the date hereof. 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.