



PrairieSky Royalty Ltd.

Consolidated Financial Statements

For the year ended December 31, 2016



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INDEPENDENT AUDITORS' REPORT

To the Shareholders of PrairieSky Royalty Ltd.

We have audited the accompanying consolidated financial statements of PrairieSky Royalty Ltd., which comprise the consolidated statements of financial position as at December 31, 2016 and December 31, 2015, the consolidated statements of earnings and comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.



Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of PrairieSky Royalty Ltd. as at December 31, 2016 and December 31, 2015, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Professional Accountants

February 27, 2017
Calgary, Canada

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(millions)		As at December 31, 2016	As at December 31, 2015
Assets			
Current Assets			
Cash and cash equivalents		\$ 34.0	\$ 190.8
Accounts receivable and accrued revenue	(Note 4)	42.5	37.6
Income tax receivable		-	21.4
Prepaid expense		0.8	0.6
		77.3	250.4
Royalty assets, net	(Note 6)	857.6	918.6
Exploration and evaluation assets	(Note 7)	1,185.5	1,148.4
Deposit	(Note 20)	15.0	-
Other assets	(Note 8)	3.9	7.6
Goodwill	(Note 9)	631.0	613.2
		\$ 2,770.3	\$ 2,938.2
Liabilities and Shareholders' Equity			
Current Liabilities			
Accounts payable and accrued liabilities	(Note 10)	\$ 19.4	\$ 14.2
Dividend payable	(Note 11)	13.7	24.7
		33.1	38.9
Share-based compensation payable	(Note 12)	3.8	2.8
Deferred income taxes	(Note 14)	198.4	186.3
		235.3	228.0
Shareholders' Equity			
Shareholders' capital	(Notes 11 & 20)	3,071.2	3,067.8
Paid in surplus		2.9	1.8
Deficit		(539.1)	(359.4)
Total Shareholders' Equity		2,535.0	2,710.2
Commitments	(Note 18)		
Subsequent events	(Note 20)		
		\$ 2,770.3	\$ 2,938.2

See accompanying Notes to Consolidated Financial Statements

Approved on behalf of the Board of Directors of PrairieSky Royalty Ltd.:

(signed) "James M. Estey"

Director

(signed) "Margaret A. McKenzie"

Director

CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME

(millions, except per share amounts)	For the year ended December 31	
	2016	2015
Revenues		
Royalty revenue	\$ 201.4	\$ 168.5
Other revenue	22.8	46.5
Revenues	224.2	215.0
Expenses		
Production and mineral taxes	5.7	8.5
Depreciation, depletion and amortization (Note 6)	162.5	96.3
Exploration and evaluation (Note 7)	6.2	2.2
Gain on disposition	-	(0.1)
Administrative (Note 13)	32.2	27.1
Net Earnings Before Finance Items and Income Taxes	17.6	81.0
Finance Items		
Finance income	(2.1)	(1.8)
Finance expense	0.2	0.6
Net Earnings Before Income Tax	19.5	82.2
Income tax expense (recovery) (Note 14)	(0.5)	19.2
Net Earnings and Comprehensive Income	\$ 20.0	\$ 63.0
Net Earnings per Common Share		
Basic and Diluted (Note 11)	\$ 0.09	\$ 0.40

See accompanying Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(millions)	Shareholders' Capital	Paid In Surplus	Deficit	Total Shareholders' Equity
Balance at December 31, 2015	\$ 3,067.8	\$ 1.8	\$ (359.4)	\$ 2,710.2
Net earnings	-	-	20.0	20.0
Common shares issued:				
Pursuant to dividend reinvestment plan (Note 11)	15.6	-	-	15.6
Pursuant to stock dividend plan (Note 11)	0.6	-	-	0.6
Share issue costs, net of tax (Note 11)	0.1	-	-	0.1
Pursuant to stock option plan (Note 11)	0.1	(0.1)	-	-
Common shares repurchased (Note 11)	(13.0)	-	(13.0)	(26.0)
Share-based compensation (Note 12)	-	1.2	-	1.2
Dividends on common shares (Note 11)	-	-	(186.7)	(186.7)
Balance at December 31, 2016	\$ 3,071.2	\$ 2.9	\$ (539.1)	\$ 2,535.0

(millions)	Shareholders' Capital	Reserve from Common Control	Paid In Surplus	Retained Earnings (Deficit)	Total Shareholders' Equity
Balance at December 31, 2014	\$ 1,181.0	\$ (255.7)	\$ 0.7	\$ 38.0	\$ 964.0
Net earnings	-	-	-	63.0	63.0
Common shares issued:					
Pursuant to dividend reinvestment plan (Note 11)	24.0	-	-	-	24.0
Pursuant to stock dividend plan (Note 11)	6.3	-	-	-	6.3
Share issue costs, net of tax (Note 11)	(6.9)	-	-	-	(6.9)
Pursuant to stock option plan (Note 11)	0.2	-	(0.2)	-	-
Pursuant to bought deal offering (Note 11)	198.0	-	-	-	198.0
Pursuant to an acquisition (Note 7)	0.5	-	-	-	0.5
Pursuant to the Transaction (Note 5)	984.9	-	-	-	984.9
Pursuant to private placement offering (Note 11)	679.8	-	-	-	679.8
Share-based compensation (Note 12)	-	-	1.3	-	1.3
Dividends on common shares (Note 11)	-	-	-	(206.5)	(206.5)
Purchase adjustment	-	1.8	-	-	1.8
Elimination of reserve from common control	-	253.9	-	(253.9)	-
Balance at December 31, 2015	\$ 3,067.8	\$ -	\$ 1.8	\$ (359.4)	\$ 2,710.2

See accompanying Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOWS

(millions)	For the year ended December 31	
	2016	2015
Operating Activities		
Net earnings	\$ 20.0	\$ 63.0
Depreciation, depletion and amortization (Note 6)	162.5	96.3
Exploration and evaluation (Note 7)	6.2	2.2
Gain on disposition	-	(0.1)
Deferred income taxes (Note 14)	(0.5)	26.5
Share-based compensation, net of cash settlements (Note 12)	8.5	3.7
Non-cash other revenue	(0.2)	(17.4)
Net change in other assets	3.7	3.6
Net change in non-cash working capital (Note 17)	4.4	(9.7)
Cash From Operating Activities	204.6	168.1
Investing Activities		
Royalty asset acquisitions (Note 6)	(45.0)	(30.7)
Exploration and evaluation acquisitions (Note 7)	(51.2)	(25.2)
Royalty business combination (Note 5)	(42.2)	(686.6)
Disposition	-	0.2
Deposit (Note 20)	(15.0)	-
Net change in non-cash working capital (Note 17)	(0.4)	0.6
Cash Used in Investing Activities	(153.8)	(741.7)
Financing Activities		
Dividends on common shares (Note 11)	(181.5)	(167.2)
Share issuance, net of costs (Note 11)	0.2	868.3
Financing costs	-	(0.1)
Common shares repurchased (Note 11)	(26.0)	-
Net change in non-cash working capital (Note 17)	(0.3)	0.3
Cash From (Used in) Financing Activities	(207.6)	701.3
Increase (Decrease) in Cash and Cash Equivalents	(156.8)	127.7
Cash and Cash Equivalents, Beginning of Year	190.8	63.1
Cash and Cash Equivalents, End of Year	\$ 34.0	\$ 190.8

See accompanying Notes to Consolidated Financial Statements

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS

PrairieSky Royalty Ltd. (“PrairieSky” or the “Company”) has a geologically and geographically diverse portfolio of fee simple mineral title, crude oil and natural gas gross overriding royalty interests and other acreage spanning Alberta, Saskatchewan, British Columbia and Manitoba (collectively, the “Royalty Properties”). The Company is focused on encouraging third parties to actively develop the Royalty Properties, while strategically seeking additional petroleum and natural gas royalty assets that provide the Company with medium-term to long-term value enhancement potential. The Company does not directly conduct operations to explore for, develop or produce petroleum or natural gas; rather, third party development of the titled or leased lands provides the Company with royalty revenue as petroleum and natural gas are produced from such properties.

The Company’s shares are publicly traded on the Toronto Stock Exchange (“TSX”) under the stock symbol “PSK”. The location of the head and registered office of the Company is Suite 1700, 350 – 7th Avenue S.W., Calgary, Alberta, T2P 3N9.

2. BASIS OF PRESENTATION

These consolidated financial statements (the “financial statements”) have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”).

These financial statements have been prepared on a historical cost basis, except for share-based payment transactions. The financial statements have been prepared on a going concern basis and amounts are in millions of Canadian dollars unless otherwise stated.

These financial statements were approved and authorized for issuance by the Company’s Board of Directors on February 27, 2017.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A) SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGMENTS

The timely preparation of financial statements requires management to make estimates and use judgment regarding the reported amounts of assets and liabilities, revenues and expenses and disclosures of contingent assets and liabilities as at the date of the financial statements. Such estimates primarily relate to fair value estimates and unsettled transactions and events as at the date of the financial statements and accordingly, actual results could differ from the estimates. Significant estimates and judgments made by management in the preparation of these financial statements are outlined below.

Critical Judgments in Applying Accounting Policies

The following are the critical judgments that management has made in the process of applying the Company’s accounting policies and that have the most significant effect on the amounts recognized in these financial statements:

The identification of cash generating units (“CGUs”) requires judgment. CGUs are defined as the lowest level of integrated assets for which there are separately identifiable cash flows that are largely independent of cash flows from other assets or groups of assets. The classification of assets and allocation of corporate assets into CGUs requires judgment and interpretation. Factors considered in the classification include how management monitors the entity’s operations, how management makes decisions about continuing or disposition of assets and operations, and the nature of the assets. Refer to Note 3(M).

Judgments are required to assess when impairment indicators, or reversal indicators, exist and impairment testing is required with respect to the carrying value of long-lived assets and goodwill.

The application of the Company's accounting policy to transfer assets from exploration and evaluation to royalty assets or to expense capitalized exploration and evaluation assets requires management to make certain judgments based on the estimated proved and probable reserves used in the determination of an area's technical feasibility and commercial viability.

Management's determination of whether a transaction constitutes a business combination or asset acquisition is determined based on the criteria in IFRS 3, "Business Combinations". Business combinations are accounted for using the acquisition method of accounting and are differentiated from an asset acquisition when business processes are associated with the assets.

Judgments include which valuation model is most appropriate to estimate fair value of awards granted under the Company's various long-term incentive plans. Estimates and assumptions are then used in the valuation model to determine the fair value, including the number of share unit awards that will ultimately vest.

Critical Accounting Estimates

The following are the key sources of estimation uncertainty at the end of the reporting period that have a significant risk of causing future adjustments to the carrying amounts of assets and liabilities.

Amounts recorded for depreciation, depletion and amortization ("DD&A"), amounts used for impairment calculations, and amounts used to determine the fair value of assets acquired through acquisitions are based on estimates of crude oil, natural gas liquids ("NGL") and natural gas reserves. By their nature, the estimates of reserves, including the estimates of future prices, costs, discount rates and the related future cash flows, are subject to measurement uncertainty. Accordingly, the impact in the financial statements of future periods could be material.

Tax provisions are based on enacted or substantively enacted laws. Changes in those laws could affect amounts recognized in the period of change and future periods. Deferred income tax assets are recognized to the extent future recovery is probable. Deferred income tax assets are reduced to the extent that it is no longer probable that sufficient taxable earnings will be available to allow all or part of the asset to be recovered.

The Company follows the accrual method of accounting, making estimates in its financial and operating results. This may include estimates of production, royalty revenue and related expenses for the period reported, for which actual results have not yet been received. The Company has no operational control over the Royalty Properties and as a result, the Company uses historical production information to estimate revenue accruals. These accrual estimates are expected to be revised, based on the receipt of actual production results.

Refer to Note 3(Q) regarding estimation uncertainty with respect to fair values assigned in a business combination.

B) FUNCTIONAL AND PRESENTATION CURRENCY

These financial statements are presented in Canadian dollars, which is the functional currency of PrairieSky.

C) REVENUE RECOGNITION

Royalty revenue on the sale of crude oil, NGL and natural gas is recognized when the product is produced. Revenue that is taken in kind is recognized when the significant risks and rewards of ownership of the product are transferred to the buyer, which is usually when legal title is transferred to the external party.

Revenue is measured at fair value of the consideration received or receivable when management can reliably estimate the amount, pursuant to the terms of the lease agreements. Differences between estimates and actual amounts are adjusted and recorded in the period that the actual amounts are received.

Other revenue is comprised of all non-product related revenue streams, including revenue generated from lease rentals, bonus consideration received when new leases are negotiated and penalty payments for non-performance under required lease conditions. Revenue from each of these streams is recognized when the consideration is received or collection is certain.

D) PRODUCTION AND MINERAL TAXES

Production and mineral taxes relate to payments made to provincial governments based on acreage or production of crude oil and natural gas on non-government owned lands and are recognized when the product is produced.

E) SHARE-BASED COMPENSATION

The Company's long term incentive plans include a Stock Option Plan and share unit award plans (Restricted Share Unit ("RSU") Plan, Performance Share Unit ("PSU") Plan, and a Deferred Share Unit ("DSU") Plan). Obligations for payments of cash or common shares under the Company's long term incentive plans are accrued over the vesting period using fair values.

For the equity-settled Stock Option Plan, fair values are determined at the grant date and are recognized over the vesting period as compensation costs with a corresponding increase to paid in surplus. When the awards are exercised, the associated paid in surplus is recognized in shareholders' capital. The Company uses the Black-Scholes option pricing model which requires that management make assumptions for the expected life of the option, the anticipated volatility of the share price over the life of the option, the risk-free interest rate for the life of the option, and the number of options that will ultimately vest.

The assumptions used by the Company are discussed in Note 12.

For share unit awards, fair values are determined at grant date and subsequently revalued at each reporting date based on the market value of the Company's common shares and are recognized over the vesting period as compensation costs, with a corresponding change to liabilities. The valuation incorporates the period-end share price, dividends declared during the period, the number of units outstanding at each period end and certain management estimates, such as estimated forfeiture rates and a performance multiplier for PSUs. Classification of the associated short-term and long-term liabilities is dependent on the expected payout dates.

F) INCOME TAXES

Income tax is recognized in net earnings except for items directly related to shareholders' equity, in which case it is recognized in shareholders' capital or other comprehensive income. Current income taxes are measured at the amount expected to be recoverable from or payable to the taxation authorities based on the income tax rates enacted or substantively enacted at the end of the reporting period.

The Company follows the asset and liability method of accounting for income taxes. Under this method, deferred income taxes are recorded for the effect of any temporary difference between the accounting and income tax basis of an asset or liability.

Deferred income tax is calculated using the enacted or substantively enacted income tax rates expected to apply when the assets are realized or liabilities are settled. The effect of a change in the enacted or substantively enacted tax rates is recognized in net earnings or in shareholders' capital depending on the item to which the adjustment relates.

Deferred income tax liabilities and assets are not recognized for temporary differences arising on:

- the initial recognition of goodwill; or
- the initial recognition of an asset or liability in a transaction which is not a business combination and, at the time of the transaction, affects neither accounting net earnings nor taxable earnings.

Deferred income tax assets are recognized to the extent future recovery is probable. Deferred income tax assets are reduced to the extent that it is no longer probable that sufficient taxable earnings will be available to allow all or part of the asset to be recovered.

G) EARNINGS PER SHARE AMOUNTS

Basic net earnings per common share is computed by dividing net earnings by the weighted average number of common shares outstanding during the period. Diluted net earnings per common share is calculated giving effect to the potential dilution that would occur if stock options were exercised or other contracts to issue common shares were exercised, fully vested, or converted to common shares. The treasury stock method is used to determine the dilutive effect of stock options and other dilutive instruments. The treasury stock method assumes that proceeds received from the exercise of in-the-money stock options and other dilutive instruments are used to repurchase common shares at the average market price for the period.

H) CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on hand and short-term investments, such as money market deposits or similar type instruments, with a maturity of three months or less when purchased.

I) EXPLORATION AND EVALUATION

Exploration and evaluation (“E&E”) assets consist of expenditures incurred in an exploration area pending the determination of technical feasibility and commercial viability. These costs include unproved property acquisition costs, undeveloped land, mineral leases, seismic, and the carrying value of E&E assets acquired from Encana Corporation (“Encana”) on May 27, 2014. Assets classified as E&E are not amortized or depleted.

Technical feasibility and commercial viability is considered to be determinable when proved and probable reserves are determined to exist and are capable of economic production. When an area is determined to be technically feasible and commercially viable, the accumulated costs are transferred to royalty assets. When an area is determined not to be technically feasible and commercially viable, the unrecoverable costs are charged to net earnings as E&E expense.

J) ROYALTY ASSETS

Royalty assets are measured at cost less accumulated depletion, depreciation and amortization. All costs directly associated with fee simple lands and royalty interests are capitalized on an area-by-area basis. Costs include acquisitions of royalty interests with proved or probable reserves, transfers of exploration and evaluation assets and the carrying value of royalty assets acquired from Encana.

Costs accumulated within each area are depleted using the unit-of-production method based on proved plus probable reserves using estimated future prices and costs.

For divestitures of properties, a gain or loss is recognized in net earnings. Exchanges of properties are measured at fair value, unless the transaction lacks commercial substance or fair value cannot be reliably measured. Where the exchange is measured at fair value, a gain or loss is recognized in net earnings.

Costs associated with office furniture, fixtures, leasehold improvements and information technology are carried at cost and depreciated on a straight-line basis over the estimated service lives of the assets, which range from three to 10 years.

K) BUSINESS COMBINATIONS

Business combinations within the scope of IFRS 3 are accounted for using the acquisition method. The acquired identifiable net assets are measured at their fair value at the date of acquisition. Deferred taxes are recognized for any differences between the fair value and the tax basis of net assets acquired. Any excess of the purchase price over the fair value of the net assets acquired is recognized as goodwill. Any deficiency of the purchase price below the fair value of the net assets acquired is recorded as a gain in net earnings. Associated transaction costs are expensed when incurred. When a business combination includes a non-controlling interest, the non-controlling interest is initially measured based on either its fair value or its proportionate share of the fair value of identifiable net assets acquired.

In connection with the acquired royalty business from Encana on May 27, 2014, the Company was a wholly owned subsidiary and controlled by Encana prior to closing the Initial Public Offering (“IPO”), and immediately subsequent to closing. Business combinations involving entities under common control are outside the scope of IFRS 3 “Business Combinations”. IFRS provides no guidance on the accounting for these types of transactions. As a result, the Company was required to develop an accounting policy. The three most common methods utilized are the purchase method, the predecessor values since inception method, and the predecessor values from date of transaction method. Management determined that the predecessor values from date of transaction method to be the most appropriate. This method requires the financial statements to be prepared using the predecessor carrying values without an adjustment to fair value. The difference between any consideration given and the aggregate carrying value of the assets and liabilities acquired, was recorded as a reserve from common control in shareholders’ equity and collapsed into retained earnings in 2015.

L) PRINCIPLES OF CONSOLIDATION

The financial statements include the accounts of the Company and all of its subsidiary companies. Subsidiaries are all entities over which the Company has control. Subsidiaries are consolidated from the date on which the Company obtains control. They are deconsolidated from the date that control ceases.

Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. All intercompany balances and transactions, and any unrealized income and expenses, arising from intercompany transactions are eliminated in full.

M) IMPAIRMENT OF LONG-TERM ASSETS

The carrying value of long-term assets, excluding goodwill, is reviewed at each reporting date for indicators that the carrying value of an asset or CGU may not be recoverable. E&E assets are also reviewed for impairment indicators and assessed for impairment upon reclassification from E&E assets to royalty assets. If indicators of impairment exist, the recoverable amount of the asset or CGU is estimated. If the carrying value of the asset or CGU exceeds the recoverable amount, the asset or CGU is written down with an impairment recognized in net earnings. A CGU is the lowest level at which there are identifiable cash inflows that are largely independent of the cash inflows of other CGUs. Based on the interdependency of the cash flows, costs capitalized in areas within royalty assets and E&E assets are aggregated into one CGU.

The recoverable amount of an asset or CGU is the greater of its fair value less costs of disposal or its value in use. Fair value less costs of disposal is the amount obtainable from the sale of assets in an arm’s length transaction less costs of disposal. Value in use is determined by estimating the present value of the future net cash flows expected to be derived from the continued use of the CGU.

Reversals of impairments are recognized when there has been a subsequent increase in the recoverable amount. In this event, the carrying amount of the asset or CGU is increased to its revised recoverable amount with an impairment reversal recognized in net earnings. The recoverable amount is limited to the original carrying amount less accumulated depletion, as if no impairment had been recognized for the asset or CGU for prior periods.

N) GOODWILL

Goodwill represents the excess of consideration paid over the fair value of acquired assets and assumed liabilities recognized in a business combination. Subsequent measurement of goodwill is at cost less any accumulated impairments.

Goodwill is assessed for impairment at least annually. If the carrying amount for the CGU exceeds the recoverable amount of the CGU, including goodwill, the associated goodwill is written down with an impairment recognized in net earnings. The recoverable amounts are determined based on the greater of fair value less costs of disposal or value in use. Fair value less costs of disposal is the amount obtainable from the sale of assets in an arm's length transaction less costs of disposal. Value in use is determined by estimating the present value of the future net cash flows expected to be derived from the continued use of the CGU. Goodwill impairments are not reversed.

O) PROVISIONS AND CONTINGENCIES

Provisions are recognized when the Company has a present obligation as a result of a past event, it is probable that an outflow of resources will be required and a reliable estimate can be made of the amount of the obligation. Provisions are measured based on the discounted expected future cash outflows.

When a contingency is substantiated by confirming events, can be reliably measured and will likely result in an economic outflow, a liability is recognized in the financial statements as the best estimate required to settle the obligation. A contingent liability is disclosed where the existence of an obligation will only be confirmed by future events, or where the amount of a present obligation cannot be measured reliably or will likely not result in an economic outflow. Contingent assets are only disclosed when the inflow of economic benefits is probable. When the economic benefit becomes virtually certain, the asset is no longer contingent and is recognized in the financial statements.

P) FINANCIAL INSTRUMENTS

Financial instruments are measured at fair value on initial recognition of the instrument. Measurement in subsequent periods depends on whether the financial instrument has been classified as "fair value through profit or loss", "loans and receivables", "available-for-sale", "held-to-maturity", or "other financial liabilities" as defined by the accounting standard.

Financial assets and financial liabilities at "fair value through profit or loss" are either classified as "held for trading" or "designated at fair value through profit or loss" and are measured at fair value with changes in those fair values recognized in net earnings. Financial assets classified as "loans and receivables", "held-to-maturity", and "other financial liabilities" are measured at amortized cost using the effective interest method of amortization. Financial assets classified as "available-for-sale" are measured at fair value, with changes in fair value recognized in other comprehensive income.

Accounts receivable, accrued revenue, and royalty note receivable are classified as "loans and receivables" and are measured at amortized cost. Accounts payable and accrued liabilities and dividends payable are classified as "other financial liabilities" and are measured at amortized cost. The Company has not designated any financial instruments as "available-for-sale", "held-to-maturity" or "fair value through profit and loss".

Q) FAIR VALUE MEASUREMENTS

The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

The fair value of royalty assets recognized in a business combination is based on market values. The market value of royalty assets is the estimated amount for which royalty assets could be exchanged on the acquisition date between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and with compulsion. The market value of royalty assets are estimated with reference to the cash flow multiples from production based on cash flow multiples of the same or similar assets, or are based on estimates of the reserves acquired. The market value of E&E assets are estimated with reference to the market values of current arm's length transactions in comparable locations. The assumptions and estimates with respect to determining the fair value of royalty and E&E assets in a business combination generally include estimates of reserves acquired, forecast benchmark commodity prices, and discount rates. Changes in any of the assumptions or estimates used in determining the fair value of acquired assets and liabilities could impact the amounts assigned to assets, liabilities and goodwill. Future net earnings can be affected as a result of changes in future DD&A, asset impairment or goodwill impairment.

The fair value of cash and cash equivalents, accounts receivable and accrued revenue, royalty note receivable, dividends payable, accounts payable and accrued liabilities is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date.

All financial assets and liabilities for which fair value is measured or disclosed in the financial statements are further categorized using a three-level hierarchy that reflects the significance of the lowest level of inputs used in determining fair value. Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis. Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace. Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

R) RECENT ACCOUNTING PRONOUNCEMENTS

New Standards Issued Not Yet Adopted

On April 26, 2016, the IASB issued its final amendments to IFRS 15, "Revenue from Contracts with Customers", which replaces IAS 18 "Revenue", IAS 11 "Construction Contracts" and related interpretations. IFRS 15 provides a single, principles-based five-step model to be applied to all contracts with customers. The standard requires an entity to recognize revenue to reflect the transfer of goods and services for the amount it expects to receive, when control is transferred to the purchaser. Disclosure requirements have also been expanded. The standard is required to be adopted either retrospectively or by recognizing the cumulative effect of initially applying IFRS 15 as an adjustment to opening equity at the date of initial application for annual periods beginning on or after January 1, 2018, with earlier adoption permitted. The Company intends to adopt IFRS 15 in its financial statements for the annual period beginning on January 1, 2018. The Company has created a plan and is currently in the process of reviewing its various revenue streams and underlying leases with third parties to determine the impact, if any, that the adoption of IFRS 15 will have on its financial statements, as well as the impact that adoption of the standard will have on disclosure.

On July 24, 2014, the IASB issued IFRS 9, “Financial Instruments”, which replaces IAS 39, “Financial Instruments: Recognition and Measurement”. The new standard introduces new requirements for the classification and measurement of financial assets and liabilities. Financial assets are classified and measured based on the business model in which they are held and the characteristics of their contractual cash flows. IFRS 9 amends the impairment model by introducing a new model for calculating impairment and includes a new hedge accounting model that better reflects risk management activities in the financial statements of entities that elect to apply hedge accounting. IFRS 9 will apply retrospectively, for annual periods beginning on or after January 1, 2018 and early adoption is permitted. The Company intends to adopt IFRS 9 in its financial statements for the annual period beginning on January 1, 2018. The Company does not expect the standard to have a material impact on the Company’s financial statements.

On January 13, 2016, the IASB issued IFRS 16, “Leases”. The standard is required to be adopted either retrospectively or by recognizing the cumulative effect of initially applying IFRS 16 as an adjustment to opening equity at the date of initial application. IFRS 16 is effective for fiscal years beginning on or after January 1, 2019, with earlier adoption permitted if IFRS 15 “Revenue from Contracts with Customers” has also been adopted. Under the new standard, companies will recognize new assets and liabilities, bringing off-balance sheet leasing arrangements onto the balance sheet. The Company intends to adopt IFRS 16 in its financial statements for the annual period beginning on January 1, 2019. The Company does not expect the standard to have a material impact on the financial statements.

4. ACCOUNTS RECEIVABLE AND ACCRUED REVENUE

	As at December 31, 2016	As at December 31, 2015
Trade receivables and accrued revenue	\$ 38.7	\$ 33.3
Current portion of royalty note receivable <i>(Note 8)</i>	3.7	3.6
Production and mineral taxes receivable	-	0.5
Interest receivable	0.1	0.2
	\$ 42.5	\$ 37.6

Trade receivables and accrued revenue relate to lease and royalty payments receivable. The analysis of accounts receivable and accrued revenue that are past due but not impaired is as follows:

	Total	Neither past due nor impaired	Past due but not impaired	
			4 - 6 Months	7 - 12 Months
As at December 31, 2016	\$ 42.5	\$ 42.3	\$ 0.1	\$ 0.1
As at December 31, 2015	\$ 37.6	\$ 37.0	\$ 0.4	\$ 0.2

At December 31, 2016, there was no allowance or provision made for doubtful accounts. In determining the recoverability of trade receivables that are past due but not impaired, the Company considers the age of the outstanding receivables and the credit worthiness of the counterparties. See Note 16 for further information about credit risk.

5. BUSINESS COMBINATIONS

A) 2016

On November 17, 2016, the Company completed a corporate acquisition of a private company (the “Corporate Acquisition”) for cash consideration of \$54.0 million, subject to closing adjustments.

The following table summarizes the net assets acquired and liabilities assumed.

Consideration:

Cash consideration	\$ 54.0
Closing adjustments	0.1
Total consideration	\$ 54.1

Net Assets Acquired:

Royalty assets	\$ 20.6
Exploration and evaluation assets	27.8
Goodwill	17.8
Working capital items	0.4
Deferred income taxes	(12.5)
Net assets acquired	\$ 54.1

The value attributed to the royalty assets acquired was determined with reference to an engineering report prepared by third party reserve evaluators using proved developed producing royalty reserves discounted at approximately 5%.

The value attributed to the exploration and evaluation assets was determined with consideration of future development potential for the heavy and thermal oil project on which the Company acquired an overriding royalty interest ("GORR").

The goodwill is attributed to the upside potential in the lands from future phases in a long life heavy and thermal oil project. The Corporate Acquisition is consistent with PrairieSky's strategy of seeking additional petroleum and natural gas royalty assets that are near term accretive to shareholders along with adding medium to long term value enhancement potential through all commodity cycles.

Transaction costs of \$0.1 million are included in 2016 administrative expenses.

From the date of acquisition, November 16, 2016, to December 31, 2016, approximately \$0.3 million of revenue and approximately \$0.2 million of net income were recognized. If the Corporate Acquisition had been effective on January 1, 2016, management estimates that pro forma revenue and pro forma net income for the year ended December 31, 2016 would have been approximately \$225.7 million and \$20.5 million, respectively. In calculating the pro forma information, the results of the Corporate Acquisition for the period before acquisition have been adjusted for fair value adjustments recorded on acquisition.

B) 2015

On December 16, 2015, the Company completed an acquisition of royalty properties from a third party (the "Transaction") for cash consideration of \$680.0 million, before closing adjustments of \$4.5 million, and the issuance of 44.4 million common shares at the December 16, 2015 share price of \$22.16 per share. To finance a portion of the purchase price, PrairieSky completed a non-brokered private placement of 26,976,000 subscription receipts at a price of \$25.20 per subscription receipt on December 2, 2015 for gross proceeds of \$679.8 million. The subscription receipts converted to common shares on December 16, 2015 concurrently with closing the Transaction. The effective date of the Transaction was October 1, 2015.

During the year ended December 31, 2016, preliminary estimates of revenue on the royalty properties acquired from the effective date to the closing date of the Transaction were finalized. Actual revenue was \$1.2 million greater than estimated, resulting in a decrease in goodwill and total consideration paid of \$1.2 million. The Company collected \$14.5 million in receivables and paid \$2.7 million related to the final settlement of adjustments resulting in an \$11.8 million cash inflow from the Transaction during 2016. The Company does not anticipate any further adjustment in subsequent periods.

The following table summarizes the net assets acquired and liabilities assumed.

Consideration:

Issuance of 44.4 million common shares of PrairieSky	\$ 984.9
Cash consideration	680.0
Closing adjustments	(4.5)
Total Consideration	\$ 1,660.4

Net Assets Acquired:

Royalty assets	\$ 435.3
Exploration and evaluation assets	1,016.7
Goodwill	276.4
Deferred income taxes	(68.0)
Net assets acquired	\$ 1,660.4

The value attributed to the royalty assets acquired was determined with reference to an engineering report prepared by third party reserve evaluators using proved plus probable reserves discounted at approximately 5%.

The value attributed to the exploration and evaluation assets was determined with reference to recent undeveloped land acquisitions in close proximity to the interests purchased, along with consideration of future development potential for the acquired lands.

The goodwill is attributed to the upside potential in the lands from future technological advances, unidentified drilling locations, and synergies achieved from integrating the royalty assets from two of the largest fee simple mineral title and royalty positions in Western Canada into a single Canadian enterprise, creating the largest independent oil and natural gas royalty position in Western Canada. The Transaction is consistent with PrairieSky's strategy of seeking additional petroleum and natural gas royalty assets that are near term accretive to shareholders along with adding medium to long term value enhancement potential through all commodity cycles.

Transaction costs of \$0.7 million are included in 2015 administrative expenses.

From the date of acquisition, December 16, 2015, to December 31, 2015, approximately \$2.3 million of revenue and approximately \$1.3 million of net loss were recognized. If the Transaction had been effective on January 1, 2015, management estimates that pro forma revenue and pro forma net earnings for the year ended December 31, 2015 would have been approximately \$291.3 million and \$73.6 million, respectively. In calculating the pro forma information, the results of the Transaction for the period before acquisition have been adjusted for fair value adjustments recorded on acquisition.

6. ROYALTY ASSETS, NET

	As at December 31, 2016	As at December 31, 2015
Cost		
Balance, Beginning of Year	\$ 1,039.7	\$ 557.4
Assets acquired through business combination (Note 5)	20.6	435.3
Other asset acquisitions	45.2	44.9
Transfers from exploration & evaluation assets (Note 7)	35.7	2.1
Balance, End of Year	1,141.2	1,039.7
Accumulated Depletion, Depreciation and Amortization		
Balance, Beginning of Year	(121.1)	(24.8)
Depletion, depreciation and amortization	(162.5)	(96.3)
Balance, End of Year	(283.6)	(121.1)
Net Book Value, End of Year	\$ 857.6	\$ 918.6

For the year ended December 31, 2016, assets acquired totaled \$65.8 million (2015 - \$480.2 million) which primarily include the Corporate Acquisition and acquisitions of fee land and producing gross overriding royalties. During the year ended December 31, 2016, there was a non-monetary acquisition of fee lands valued at \$0.2 million. During the year ended December 31, 2015, there was a non-monetary acquisition of a gross overriding royalty interest valued at \$14.2 million.

7. EXPLORATION AND EVALUATION ASSETS

	As at December 31, 2016	As at December 31, 2015
Cost		
Balance, Beginning of Year	\$ 1,148.4	\$ 107.8
Assets acquired through business combination (Note 5)	27.8	1,016.7
Other asset acquisitions	51.2	28.2
Transfers to royalty assets	(35.7)	(2.1)
Land expiries	(6.2)	(2.2)
Balance, End of Year	\$ 1,185.5	\$ 1,148.4

For the year ended December 31, 2016, the Company acquired \$79.0 million (2015 - \$1,044.9 million) in E&E assets, which primarily include the Corporate Acquisition and seismic and land acquisitions.

Other asset acquisitions of \$28.2 million in 2015 included the following non-monetary transactions: share consideration of \$0.5 million was exchanged on a GORR acquisition, the Company exchanged lease issuance bonus proceeds for E&E assets valued at \$1.5 million, and a non-monetary \$1.0 million non-performance payment was exchanged for a GORR.

8. OTHER ASSETS

At December 31, 2016, the Company had a royalty note receivable of \$7.6 million (December 31, 2015 - \$11.2 million) outstanding which is receivable in equal monthly instalments over the next two years bearing interest of four percent per annum. During the year ended December 31, 2016, \$0.4 million (2015 - \$0.5 million) of interest income was recorded related to the royalty note receivable. The non-current portion of the royalty note receivable of \$3.9 million (December 31, 2015 - \$7.6 million) is classified as other assets. The current portion of the note receivable of \$3.7 million (December 31, 2015 - \$3.6 million) is included in accounts receivable and accrued revenue as disclosed in Note 4. As at December 31, 2016, the royalty note receivable had a fair value of \$7.6 million (December 31, 2015 - \$11.1 million). The estimated fair value of other assets is categorized within Level 2 of the fair value hierarchy and has been determined based on

market information where available using estimated interest rates based on the credit quality of the customer.

9. GOODWILL

Goodwill is assessed for impairment at least annually. The recoverable amount of the Company's sole CGU used to assess goodwill was determined using fair value less costs of disposal. Fair value less costs of disposal was estimated for the CGU using cash flow multiples from production of same or similar assets. The impairment test of goodwill at December 31, 2016 concluded that the estimated recoverable amount, including goodwill, exceeded the carrying amount of the CGU. As such, no goodwill impairment existed. There have been no changes to the valuation technique during the year. At December 31, 2016, the market capitalization of the Company was \$7.3 billion.

Goodwill		As at December 31, 2016	As at December 31, 2015
Balance, Beginning of Year		\$ 613.2	\$ 336.8
Acquired in the Corporate Acquisition	<i>(Note 5A)</i>	17.8	-
Acquired in the Transaction	<i>(Note 5B)</i>	-	276.4
Balance, End of Year		\$ 631.0	\$ 613.2

The key assumption used in the estimation of the recoverable amount is a cash flow multiple of eight to ten times cash flow. The value assigned to the key assumption represents management's assessment of recent historical data from both internal and external sources, as well as cash flow multiples anticipated for future transactions.

10. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	As at December 31, 2016	As at December 31, 2015
Trade payables	\$ 2.9	\$ 1.9
Production and mineral taxes payable	6.4	9.4
Accrued liabilities	10.1	2.9
	\$ 19.4	\$ 14.2

Accrued liabilities primarily include amounts related to cash settled share-based compensation accruals.

11. SHARE CAPITAL

AUTHORIZED

The authorized share capital of the Company includes an unlimited number of common shares and an unlimited number of preferred shares issuable in series. The holders of the common shares are entitled to one vote in respect of each common share held at all meetings of shareholders, except meetings at which only holders of a specified class of share have the right to vote. The common shares have no par value.

ISSUED AND OUTSTANDING

	As at December 31, 2016		As at December 31, 2015	
	Number of Shares (millions)	Amount (\$ millions)	Number of Shares (millions)	Amount (\$ millions)
Common Shares Outstanding, Beginning of Year	228.2	\$ 3,067.8	149.3	\$ 1,181.0
Issued pursuant to dividend reinvestment plan	0.8	15.6	1.1	24.0
Issued pursuant to stock dividend program	-	0.6	0.1	6.3
Share issue costs, net of tax	-	0.1	-	(6.9)
Issued pursuant to stock option plan	-	0.1	-	0.2
Common shares repurchased	(1.0)	(13.0)	-	-
Issued pursuant to bought deal offering	-	-	6.3	198.0
Issued pursuant to an acquisition	-	-	-	0.5
Issued pursuant to the Transaction	-	-	44.4	984.9
Issued pursuant to private placement offering	-	-	27.0	679.8
Common Shares Outstanding, End of Year	228.0	\$ 3,071.2	228.2	\$ 3,067.8

COMMON SHARES

A) 2016

NORMAL COURSE ISSUER BID (“NCIB”)

On April 27, 2016, the Company announced the approval of its NCIB by the TSX. The NCIB allows the Company to purchase for cancellation up to a maximum of 1,600,000 common shares over the twelve month period commencing on May 2, 2016. The NCIB will continue until May 1, 2017, at which time the Company may apply to renew the NCIB at the same or at a higher/lower level for an additional 12-month period. Purchases will be made on the open market through the TSX or alternative platforms at the market price of such common shares. All common shares purchased under the NCIB are cancelled.

During the year ended December 31, 2016, the Company purchased for cancellation 960,000 common shares at an average cost of \$27.04 per common share for total consideration of \$26.0 million. The total cost paid, including commissions and fees, was first charged to share capital to the extent of the average carrying value of the common shares purchased and the excess of \$13.0 million was charged to the deficit for the year.

B) 2015

On July 7, 2015, the Company completed a bought deal prospectus offering of common shares. Pursuant to the offering, the Company issued 6.3 million common shares, including 0.6 million common shares issued pursuant to the exercise in full of the over-allotment option granted to the underwriters at a price of \$31.25 per common share for aggregate gross proceeds of \$198.0 million and net proceeds of \$189.5 million.

On December 2, 2015, PrairieSky issued 27.0 million subscription receipts at a price of \$25.20 per subscription receipt by way of a private placement to certain investors for aggregate gross proceeds of \$679.8 million and net proceeds of \$678.8 million. In conjunction with the closing of the Transaction described in Note 5(B), each holder of the subscription receipts received one common share of PrairieSky for each subscription receipt held.

On December 16, 2015, PrairieSky issued 44.4 million common shares to a third party as partial consideration for the Transaction.

DIVIDENDS

During the year ended December 31, 2016, PrairieSky declared dividends of \$186.7 million (December 31, 2015 - \$206.5 million) or \$0.81666 per common share (December 31, 2015 - \$1.29996) and paid dividends of \$197.7 million (December 31, 2015 - \$197.5 million) or \$0.86499 per common share (December 31, 2015 - \$1.29743). Of the total dividends paid in 2016, \$181.5 million (December 31, 2015 - \$167.2 million) was settled in cash and an additional \$16.2 million (December 31, 2015 - \$30.3 million) was settled in common shares in lieu of cash dividends under the dividend reinvestment plan ("DRIP") and stock dividend plan ("SDP").

On February 29, 2016, the Company reduced its dividend to \$0.72 per common share per annum and suspended the DRIP and the SDP, all effective for the March 31, 2016 record date. On December 15, 2016, the Board of Directors declared a dividend of \$0.06 per common share (\$13.7 million) payable on January 16, 2017 to common shareholders of record on December 30, 2016.

EARNINGS PER COMMON SHARE

The following table presents the computation of net earnings per common share:

	Year ended December 31	
	2016	2015
Net Earnings	\$ 20.0	\$ 63.0
Number of Common Shares:		
Weighted Average Common Shares Outstanding - Basic	228.6	155.7
Effect of Dilutive Securities	0.2	0.3
Weighted Average Common Shares Outstanding - Diluted	228.8	156.0
Net Earnings per Common Share - Basic and Diluted	\$ 0.09	\$ 0.40

12. SHARE-BASED COMPENSATION PLANS

The Company has a number of share-based compensation arrangements under which the Company awards various types of long-term incentive grants to eligible employees, officers and directors. They include stock options, performance share units ("PSUs"), restricted share units ("RSUs"), and deferred share units ("DSUs").

The Company accounts for stock options granted to Company employees and officers as equity-settled share-based payment transactions and accrues compensation costs over the vesting period based on the fair values determined at the grant date.

The Company accounts for its share unit awards, PSUs, RSUs and DSUs, held by Company employees, officers and directors as cash-settled share-based payment transactions and accrues compensation costs and dividends over the vesting period based on the fair value at each reporting date. The Company may make an election to settle vested share unit awards with either a cash payment equal to the five-day weighted average trading price for the common shares multiplied by the number of common shares or issue the number of common shares. PSUs vest following the completion of a three year performance period provided the employee remains actively employed with the Company on the vesting date. RSUs granted to employees at the time of the initial public offering ("IPO") on May 29, 2014, vest 30% after the second anniversary of the date of grant and the remaining 70% vest after the third anniversary, while subsequent grants vest evenly over a three year period, provided the employee remains actively employed with the Company on the vesting date. RSUs granted to officers of the Company at the time of the IPO fully vest three years from the date of grant, while subsequent grants vest evenly over a three year period provided the officer remains actively employed with the Company on the vesting date. DSUs are fully vested as of the grant date.

The Company has recognized the following share-based compensation costs:

	Year ended December 31	
	2016	2015
Compensation costs of transactions classified as equity-settled	\$ 1.2	\$ 1.3
Compensation costs of transactions classified as cash-settled	9.0	3.4
Total share-based compensation expense	\$ 10.2	\$ 4.7

The Company has recognized the following liability for share-based payment transactions:

	As at	As at
	December 31, 2016	December 31, 2015
Liability for unvested cash-settled plans	\$ 9.7	\$ 2.8
Liability for vested cash-settled plans	2.1	1.7
Liability for cash-settled plans	\$ 11.8	\$ 4.5

As at December 31, 2016, \$8.0 million (December 31, 2015 - \$1.7 million) of the liability for cash-settled plans, which represents the value of the PSUs, RSUs and DSUs that are vested or will vest in the next twelve months, is included in accounts payable and accrued liabilities. The remaining \$3.8 million (December 31, 2015 - \$2.8 million) is a long-term liability and is reported as the share-based compensation payable.

A) STOCK OPTIONS

The Company has a Stock Option Plan that provides for granting of stock options to officers and certain employees. Stock options vest over a three year period and expire five years after the date of the grant.

The following table summarizes the change in stock options outstanding:

	Number (thousands)	Weighted average exercise price (\$)
Issued and Outstanding, December 31, 2014	511.5	29.01
Granted	354.7	30.10
Exercised	(54.9)	28.00
Forfeited	(18.0)	28.93
Issued and Outstanding, December 31, 2015	793.3	29.57
Granted	371.3	22.55
Exercised	(15.2)	(25.90)
Forfeited	(116.8)	(31.75)
Issued and Outstanding, December 31, 2016	1,032.6	26.85

The average share price on the date of the option exercise was \$33.05 in 2016 (2015 - \$31.50).

The following weighted average assumptions were used to determine the fair value of stock options granted by the Company during the year:

	December 31, 2016	December 31, 2015
Risk free interest rate	0.73%	0.77%
Dividend yield	5.76%	4.34%
Expected volatility rate based on historical volatility	36%	27%
Forfeiture rate	6.4%	6.4%
Expected life	5 yrs	5 yrs
Weighted average grant price	\$22.55	\$30.10
Fair value per option on grant date	\$3.62	\$4.06

The following table summarizes information regarding stock options outstanding at December 31, 2016:

Range Of Exercise Prices Per Common Share	Number of options outstanding	Weighted average remaining life (years)	Weighted average exercise price for options outstanding (\$/share)	Number of options exercisable	Weighted average exercise price for options exercisable (\$/share)	Weighted average fair value for options outstanding (\$/share)
\$22.50-\$28.00	771,168	3.18	25.51	238,636	28.00	3.71
\$30.80-\$30.88	261,404	3.16	30.81	78,421	30.81	3.93

The following table summarizes information regarding stock options outstanding at December 31, 2015:

Range Of Exercise Prices Per Common Share	Number of options outstanding	Weighted average remaining life (years)	Weighted average exercise price for options outstanding (\$/share)	Number of options exercisable	Weighted average exercise price for options exercisable (\$/share)	Weighted average fair value for options outstanding (\$/share)
\$25.90-\$28.00	448,352	3.58	27.76	119,318	28.00	3.82
\$30.80-\$39.03	344,936	4.09	31.93	14,063	39.03	4.24

For the year ended December 31, 2016, administrative expense includes \$1.2 million (December 31, 2015 - \$1.3 million) of compensation costs related to stock options.

B) PERFORMANCE SHARE UNITS

PSUs have been granted to officers and entitle the officer to receive upon vesting a cash payment that is equal to the value of one common share of the Company for each PSU held, plus accrued dividends over the period from the date of grant to vesting, or the equivalent number of shares at the election of the Company.

The ultimate value of the PSUs will depend upon the Company's performance relative to predetermined corresponding performance targets measured over a three-year period. Performance is based on the Company's total shareholder return ("TSR"), defined as share price appreciation plus dividends, relative to the TSR for a predetermined performance peer group. Based on this assessment, a range of zero to two times the original PSU grant, at the discretion of the Board of Directors, may be eligible to vest in respect of the three year trailing period being measured.

The following table summarizes information related to the PSUs:

<i>Outstanding PSUs (thousands of units)</i>	December 31, 2016	December 31, 2015
Issued and Outstanding, Beginning of Year	140.8	67.8
Granted	89.4	84.5
Deemed eligible to vest	(11.1)	(16.5)
Forfeited	(19.7)	-
Units, in lieu of dividends	5.5	5.0
Issued and Outstanding, End of Year	204.9	140.8

For the year ended December 31, 2016, the Company recorded a compensation expense of \$3.2 million (December 31, 2015 - \$1.3 million) related to outstanding PSUs. The market common share price used in the PSU fair value calculation at December 31, 2016 was \$31.94 (December 31, 2015 - \$21.92). The remaining weighted average life is 1.4 years.

C) RESTRICTED SHARE UNITS

RSUs have been granted to eligible employees and entitle the employee to receive upon vesting a cash payment that is equal to the value of one common share for each RSU held, plus accrued dividends over the period from the date of grant to vesting, or the equivalent number of shares at the election of the Company.

The following table summarizes information related to the RSUs:

<i>Outstanding RSUs (thousands of units)</i>	December 31, 2016	December 31, 2015
Issued and Outstanding, Beginning of Year	206.2	112.3
Granted	118.6	130.2
Deemed eligible to vest	(5.5)	(9.1)
Forfeited	(24.7)	(35.1)
Exercised	(55.1)	-
Units, in lieu of dividends	6.8	7.9
Issued and Outstanding, End of Year	246.3	206.2

For year ended December 31, 2016, the Company recorded compensation costs of \$4.4 million (December 31, 2015 - \$1.8 million) related to outstanding RSUs. The market common share price used in the RSU fair value calculation at December 31, 2016 was \$31.94 (December 31, 2015 - \$21.92). The remaining weighted average life is 0.8 years.

D) DEFERRED SHARE UNITS

Directors receive an annual compensation amount in DSUs and have the option to receive Board and Committee retainers and fees in the form of DSUs, which vest immediately. These DSUs are equivalent to a common share plus accrued dividends over the period from date of grant and vesting to the date of redemption and are settled in cash. DSUs can only be redeemed following departure from the Company and must be redeemed prior to December 15th of the year following departure. For the year ended December 31, 2016, the majority of the Directors elected to receive their annual Board and Committee retainers and fees in the form of DSUs.

The following table summarizes information related to the DSUs:

<i>Outstanding DSUs (thousands of units)</i>	December 31, 2016	December 31, 2015
Issued and Outstanding, Beginning of Year	33.0	22.8
Granted	30.2	18.8
Exercised	-	(9.8)
Units, in lieu of dividends	2.1	1.2
Issued and Outstanding, End of Year	65.3	33.0

For the year ended December 31, 2016, the Company recorded a compensation expense of \$1.4 million (December 31, 2015 - \$0.3 million) related to outstanding DSUs. The market common share price used in the DSU fair value calculation at December 31, 2016 was \$31.94 (December 31, 2015 - \$21.92).

13. ADMINISTRATIVE EXPENSE

	Year ended December 31	
	2016	2015
Salaries and benefits	\$ 14.2	\$ 13.9
Share-based compensation (Note 12)	10.2	4.7
Office expense	4.5	4.8
Public company expense	1.0	1.2
Information technology and other	2.1	1.8
Transaction costs (Note 5)	0.2	0.7
Administrative Expense	\$ 32.2	\$ 27.1

14. INCOME TAXES

	Year ended December 31	
	2016	2015
Current tax recovery	\$ -	\$ (7.3)
Deferred tax expense (recovery)	(0.5)	26.5
Income tax expense (recovery)	\$ (0.5)	\$ 19.2

The following table reconciles income taxes calculated at the Canadian statutory rate with actual income taxes:

	Year ended December 31	
	2016	2015
Net Earnings Before Income Tax	\$ 19.5	\$ 82.2
Canadian Statutory Rate	27.0%	26.0%
Expected Income Tax	5.3	21.4
Effect on Taxes Resulting From:		
Permanent Differences	(5.8)	(10.2)
Statutory Rate Difference	-	7.7
Other	-	0.3
Income tax expense	\$ (0.5)	\$ 19.2

The Company has not recognized tax deductible temporary differences of \$161.6 million as at December 31, 2016 (December 31, 2015 - \$184.3 million) related to the excess of tax pools acquired over the carrying value of net assets transferred from Encana on May 27, 2014 because the common control transaction is not a business combination and is therefore subject to the initial recognition exemption under IAS 12 "Income Taxes". Deferred income tax assets and liabilities are not recognized for temporary differences

arising on the initial recognition of an asset or liability in a transaction which is not a business combination and, at the time of the transaction, affects neither accounting profit nor taxable earnings. The unrecognized deferred income tax asset is being amortized based on the net tax pool claims calculated for the period. The reversal of the unrecognized deferred tax asset for the year ended December 31, 2016 was \$6.1 million (December 31, 2015 - \$10.3 million).

The deferred income tax charged (credited) to the Consolidated Statement of Earnings and Comprehensive Income and the net deferred income tax liability consists of:

	Balance, December 31, 2015	Recognized in net income	Recognized directly in equity	Acquired in Business Combination	Balance, December 31, 2016
Royalty and E&E assets	\$ 190.4	\$ 0.3	\$ -	\$ 13.0	\$ 203.7
Non-capital loss carry forwards	(0.8)	0.7	-	(0.5)	(0.6)
Share-based compensation	(1.2)	(2.0)	-	-	(3.2)
Share issue costs	(2.1)	0.5	0.1	-	(1.5)
Total	\$ 186.3	\$ (0.5)	\$ 0.1	\$ 12.5	\$ 198.4

	Balance, December 31, 2014	Recognized in net income	Recognized directly in equity	Acquired in Business Combination	Balance, December 31, 2015
Royalty and E&E assets	\$ 95.6	\$ 26.8	\$ -	\$ 68.0	\$ 190.4
Non-capital loss carry forwards	(0.7)	(0.1)	-	-	(0.8)
Share-based compensation	(0.5)	(0.7)	-	-	(1.2)
Share issue costs	-	0.5	(2.6)	-	(2.1)
Total	\$ 94.4	\$ 26.5	\$ (2.6)	\$ 68.0	\$ 186.3

15. CAPITAL MANAGEMENT

The Company's objective when managing its capital structure is to maintain financial flexibility in order to distribute cash to shareholders in the form of dividends and share repurchases and cancellations after consideration of the Company's financial requirements for its business and future growth opportunities. As a royalty company, PrairieSky does not have capital expenditure commitments, which enhances its financial flexibility.

The Company's capital structure is comprised of shareholders' equity and working capital. The Company's capital structure is managed by taking into account operating activities, dividends paid to shareholders, common share repurchases, taxes, available Credit Facility (Note 16), share issuance costs and other factors. The Company's operating results and capital structure are impacted by the level of development activity by third parties on the Royalty Properties and the resultant royalty production volumes, level of costs incurred by the Company and commodity prices.

	As at December 31, 2016	As at December 31, 2015
Shareholders' equity	\$ 2,535.0	\$ 2,710.2
Working capital	44.2	211.5

The Company's capital structure is managed through its financial and operating forecast process. The forecast of the Company's future cash flows is based on estimates of production, crude oil, natural gas and NGL prices, production and mineral tax expense, administrative expenses and other investing and financing

activities. The forecast is regularly updated based on changes in commodity prices, production expectations and other factors that in the Company's view could impact cash flow.

16. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

A) FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

The fair values of cash and cash equivalents, accounts receivable and accrued revenue, accounts payable and accrued liabilities and dividends payable approximate their carrying amount due to the short-term maturity of those instruments. Refer to Note 8 for the fair value of the royalty note receivable.

B) RISKS ASSOCIATED WITH FINANCIAL ASSETS AND LIABILITIES

The Company is exposed to financial risks arising from its financial assets and liabilities. Financial risks include market risk (such as commodity price and interest rate risk), credit risk and liquidity risk.

Commodity Price Risk

Commodity price risk is the risk the Company will encounter fluctuations in its future royalty revenue with changes in commodity prices. Commodity prices for crude oil, NGL and natural gas are influenced by macroeconomic events that dictate the levels of supply and demand. The Company does not hedge its commodity price risk.

Interest Rate Risk

Interest rate risk arises from changes in market interest rates that may affect the fair value or future cash flows from the Company's financial assets or liabilities.

At December 31, 2016, the Company had no interest bearing liabilities. The Company's royalty note receivable (Note 8) earns interest at a fixed rate. The cash balance on deposit at December 31, 2016 earns interest at variable rates.

Credit Risk

Credit risk arises from the potential that the Company may incur a loss if a counterparty to a financial instrument fails to meet its obligation in accordance with agreed terms. A substantial portion of the Company's accounts receivable are from royalty agreements with oil and gas industry operators and are subject to normal industry credit risks. The Company's diversified revenue stream limits the size of any one property or industry operator with respect to total receivables. In addition, the Company takes certain of its production in kind to mitigate credit risk.

As at December 31, 2016, there was one counterparty whose accounts receivable individually accounted for more than 10% of the total accounts receivable balance due to the timing of payments received at the end of the year. The maximum credit risk exposure associated with accounts receivable and accrued revenue is the total carrying value. For the periods presented, the Company does not have an allowance for doubtful accounts nor does it provide for any doubtful accounts.

Liquidity Risk

Liquidity risk is the risk that the Company will encounter difficulties in meeting a demand to fund financial liabilities as they come due. The Company manages its liquidity risk using cash and debt management programs. The Company has unused capacity under its Credit Facility, described below, for up to \$25 million.

The timing of expected cash outflows relating to accounts payable and accrued liabilities of \$19.4 million and dividend payable of \$13.7 million is less than one year.

On May 18, 2016, the Company elected to voluntarily eliminate the \$75 million revolving credit facility (the “Revolving Facility”), such that the total syndicated facility commitment is zero. The Company has retained the unsecured \$25 million extendible operating credit facility (the “Credit Facility”). The Credit Facility matures on May 29, 2018.

The Credit Facility includes borrowing options of Canadian prime rate-based advances, U.S. based rate advances, LIBOR loans, bankers’ acceptances and letters of credit, and bears interest on a variable grid based on certain financial ratios, over the prevailing applicable rate for the type of loan. The Credit Facility is unsecured, does not have a borrowing base restriction and has a two year term, extendible annually for up to three years, subject to certain requirements. The credit facility maturity date is May 29, 2018. As at December 31, 2016, the Credit Facility is undrawn.

17. SUPPLEMENTARY INFORMATION

NET CHANGE IN NON-CASH WORKING CAPITAL

	Year ended December 31	
	2016	2015
Source (use) of cash:		
Accounts receivable and accrued revenue	\$ (16.3)	\$ 41.1
Prepaid assets	(0.1)	(0.2)
Income taxes receivable	21.4	(21.4)
Accounts payable and accrued liabilities	(1.3)	(8.0)
Income taxes payable	-	(20.3)
Changes in non-cash working capital	\$ 3.7	\$ (8.8)
Related to operating activities	4.4	(9.7)
Related to investing activities	(0.4)	0.6
Related to financing activities	(0.3)	0.3
Changes in non-cash working capital	\$ 3.7	\$ (8.8)

SUPPLEMENTARY CASH FLOW INFORMATION

	Year ended December 31	
	2016	2015
Interest Paid	\$ 0.2	\$ 0.3
Interest Received	2.2	1.7
Income Taxes Paid	-	34.4
Income Taxes Received	21.4	-

18. COMMITMENTS

The following table outlines the Company’s commitments as at December 31, 2016:

(\$ millions)	Expected Future Payments						Total
	2017	2018	2019	2020	2021	Thereafter	
(undiscounted)							
Office lease commitments	\$ 1.4	\$ 1.4	\$ 1.3	\$ 1.3	\$ 1.5	\$ 3.2	\$10.1

The Company has in place three royalty acquisition agreements with unrelated parties. The agreements expire on August 1, 2017, July 31, 2018, and December 31, 2018 with remaining commitments, subject to numerous conditions, of \$2.3 million, \$4.9 million, and \$2.7 million, respectively.

19. RELATED PARTY TRANSACTIONS

Transactions with Key Management Personnel

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company.

The following table summarizes compensation expense, all of which are included in administrative expenses, related to officers and directors of the Company:

	Year ended December 31	
	2016	2015
Salaries, bonuses, and other benefits	\$ 3.2	\$ 3.3
Termination benefits	1.0	1.3
Stock options	1.3	1.2
Share unit awards	6.2	1.3
Total Compensation	\$ 11.7	\$ 7.1

20. SUBSEQUENT EVENTS

On January 6, 2017, the Company completed its previously announced acquisition of a 4% gross overriding royalty on current and future phases of the Lindbergh SAGD thermal oil project, as well as seismic over certain lands in British Columbia and Alberta, for total cash consideration of \$250 million. A cash deposit of \$15.0 million was paid upon execution of the agreement on December 14, 2016.

On January 6, 2017, the Company also completed a bought deal offering of common shares (the "Offering"). Pursuant to the Offering, the Company issued 9.2 million common shares, including 1.2 million common shares issued pursuant to the exercise in full of the over-allotment option granted to the underwriters, at a price of \$31.40 per common share, for aggregate gross proceeds of approximately \$288.9 million and net proceeds, after fees and expenses, of approximately \$276.8 million.

CORPORATE INFORMATION

BOARD OF DIRECTORS

James M. Estey⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾
Andrew M. Phillips
Sheldon B. Steeves⁽²⁾⁽³⁾⁽⁴⁾
Margaret A. McKenzie⁽³⁾⁽⁴⁾
Grant Zawalsky⁽²⁾⁽⁴⁾

- (1) Chair of the Board.
- (2) Member of the Governance and Compensation Committee. Mr. Estey is the Chair of the Governance and Compensation Committee.
- (3) Member of the Audit Committee. Ms. McKenzie is the Chair of the Audit Committee.
- (4) Member of the Reserves Committee. Mr. Steeves is the Chair of the Reserves Committee. Mr. Estey is an ex-officio non-voting member of the Reserves Committee.

OFFICERS

Andrew M. Phillips, President & Chief Executive Officer
Cameron M. Proctor, Chief Operating Officer
Pamela Kazeil, Vice President, Finance & Chief Financial Officer
Michelle L. Radomski, Vice-President, Land

AUDITORS

KPMG LLP

BANKERS

Toronto-Dominion Bank
Canadian Imperial Bank of Commerce

TORONTO STOCK EXCHANGE TRADING SYMBOL

PSK

INDEPENDENT RESERVE EVALUATORS

GLJ Petroleum Consultants Ltd.

TRANSFER AGENT

TMX Equity Transfer Services

ABBREVIATIONS

bbls – barrels
bbls/d – barrels per day
boe – barrels of oil equivalent (6 mcf = 1 bbl)
boe/d – barrels of oil equivalent per day
mcf – thousand cubic feet
mcf/d – thousand cubic feet per day
mmcf – million cubic feet
mmcf/d – million cubic feet per day
NGL – natural gas liquids
WTI – West Texas Intermediate

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