

TSX: PSK

**INTERIM CONDENSED
CONSOLIDATED
FINANCIAL
STATEMENTS /**

FOR THE THREE AND NINE
MONTHS ENDED SEPTEMBER
30, 2018

HIGH MARGINS **ZERO** CAPITAL



CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION (UNAUDITED)

| (millions) | | As at September 30, 2018 | As at December 31, 2017 |
|---|------------|-----------------------------|----------------------------|
| Assets | | | |
| Current Assets | | | |
| Cash and cash equivalents | | \$ - | \$ 45.1 |
| Accounts receivable and accrued revenue | (Note 5) | 40.1 | 43.0 |
| Prepays | | 1.5 | 0.6 |
| | | 41.6 | 88.7 |
| Royalty assets, net | (Note 6) | 763.4 | 820.2 |
| Exploration and evaluation assets | (Note 7) | 1,427.4 | 1,431.8 |
| Goodwill | | 631.0 | 631.0 |
| Total Assets | | \$ 2,863.4 | \$ 2,971.7 |
| Liabilities and Shareholders' Equity | | | |
| Current Liabilities | | | |
| Bank debt | (Note 15b) | \$ 0.5 | \$ - |
| Accounts payable and accrued liabilities | (Note 8) | 12.8 | 17.0 |
| Income tax payable | | 2.5 | 11.3 |
| Dividend payable | (Note 9) | 15.2 | 14.7 |
| | | 31.0 | 43.0 |
| Share-based compensation payable | (Note 10) | 1.2 | 5.0 |
| Deferred income taxes | | 208.7 | 203.7 |
| Total Liabilities | | 240.9 | 251.7 |
| Shareholders' Equity | | | |
| Shareholders' capital | (Note 9) | 3,315.8 | 3,334.3 |
| Paid in surplus | | 4.2 | 2.8 |
| Deficit | | (697.5) | (617.1) |
| Total Shareholders' Equity | | 2,622.5 | 2,720.0 |
| Total Liabilities and Shareholders' Equity | | \$ 2,863.4 | \$ 2,971.7 |

See accompanying Notes to Interim Condensed Consolidated Financial Statements.

**CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME
(UNAUDITED)**

| (millions, except per share amounts) | | Three months ended September 30 | | Nine months ended September 30 | |
|--|-----------|------------------------------------|----------------|-----------------------------------|----------------|
| | | 2018 | 2017 | 2018 | 2017 |
| Revenues | | | | | |
| Royalty revenue | (Note 11) | \$ 71.4 | \$ 54.2 | \$ 205.6 | \$ 196.7 |
| Other revenue | (Note 11) | 6.7 | 17.5 | 16.6 | 57.5 |
| Revenues | | 78.1 | 71.7 | 222.2 | 254.2 |
| Expenses | | | | | |
| Administrative | (Note 12) | 4.6 | 8.4 | 15.8 | 23.6 |
| Production and mineral taxes | | 1.1 | 1.8 | 3.8 | 4.5 |
| Depletion, depreciation and amortization | (Note 6) | 35.4 | 40.8 | 105.2 | 129.3 |
| Exploration and evaluation | (Note 7) | 0.2 | 0.7 | 0.9 | 4.7 |
| Net Earnings Before Finance Items and Income Taxes | | 36.8 | 20.0 | 96.5 | 92.1 |
| Finance Items | | | | | |
| Finance income | | (0.1) | (0.4) | (0.3) | (0.9) |
| Finance expense | | 0.3 | - | 0.5 | 0.1 |
| Net Earnings Before Income Taxes | | 36.6 | 20.4 | 96.3 | 92.9 |
| Income tax expense | (Note 13) | 8.1 | 1.0 | 22.9 | 12.2 |
| Net Earnings and Comprehensive Income | | \$ 28.5 | \$ 19.4 | \$ 73.4 | \$ 80.7 |
| Net Earnings per Common Share | | | | | |
| Basic and Diluted | (Note 9) | \$ 0.12 | \$ 0.08 | \$ 0.31 | \$ 0.34 |

See accompanying Notes to Interim Condensed Consolidated Financial Statements.

**CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(UNAUDITED)**

| (millions) | Shareholders' Capital | Paid In Surplus | Deficit | Total Shareholders' Equity |
|--------------------------------------|--------------------------|-----------------|-------------------|----------------------------------|
| Balance at December 31, 2017 | \$ 3,334.3 | \$ 2.8 | \$ (617.1) | \$ 2,720.0 |
| Net earnings | - | - | 73.4 | 73.4 |
| Common shares repurchased (Note 9) | (18.5) | - | (17.4) | (35.9) |
| Share-based compensation (Note 10) | - | 1.4 | - | 1.4 |
| Dividends on common shares (Note 9) | - | - | (136.4) | (136.4) |
| Balance at September 30, 2018 | \$ 3,315.8 | \$ 4.2 | \$ (697.5) | \$ 2,622.5 |

| (millions) | Shareholders' Capital | Paid In Surplus | Deficit | Total Shareholders' Equity |
|---|--------------------------|-----------------|-------------------|----------------------------------|
| Balance at December 31, 2016 | \$ 3,071.2 | \$ 2.9 | \$ (539.1) | \$ 2,535.0 |
| Net earnings | - | - | 80.7 | 80.7 |
| Common shares issued: | | | | |
| Pursuant to bought deal offering (Note 9) | 288.9 | - | - | 288.9 |
| Share issue costs, net of tax (Note 9) | (8.8) | - | - | (8.8) |
| Pursuant to stock option plan | 1.1 | (1.8) | - | (0.7) |
| Pursuant to acquisition | 1.6 | - | - | 1.6 |
| Common shares repurchased (Note 9) | (15.0) | - | (16.2) | (31.2) |
| Share-based compensation (Note 10) | - | 1.5 | - | 1.5 |
| Dividends on common shares (Note 9) | - | - | (132.0) | (132.0) |
| Balance at September 30, 2017 | \$ 3,339.0 | \$ 2.6 | \$ (606.6) | \$ 2,735.0 |

See accompanying Notes to Interim Condensed Consolidated Financial Statements.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

| (millions) | Three months ended September 30 | | Nine months ended September 30 | |
|---|------------------------------------|-----------------|-----------------------------------|-----------------|
| | 2018 | 2017 | 2018 | 2017 |
| Operating Activities | | | | |
| Net earnings | \$ 28.5 | \$ 19.4 | \$ 73.4 | \$ 80.7 |
| Depreciation, depletion and amortization (Note 6) | 35.4 | 40.8 | 105.2 | 129.3 |
| Exploration and evaluation (Note 7) | 0.2 | 0.7 | 0.9 | 4.7 |
| Deferred income taxes (Note 13) | 2.5 | 1.7 | 5.0 | 5.0 |
| Share-based compensation, net of cash settlements (Note 10) | (0.6) | 3.3 | (6.2) | 1.7 |
| Other non-cash items | - | - | - | (15.2) |
| Net change in other assets | 1.0 | 0.9 | 2.9 | 2.9 |
| Funds from operations | 67.0 | 66.8 | 181.2 | 209.1 |
| Net change in non-cash working capital (Note 16) | 0.3 | 12.5 | (9.8) | 12.3 |
| Cash From Operating Activities | 67.3 | 79.3 | 171.4 | 221.4 |
| Investing Activities | | | | |
| Royalty asset acquisitions (Note 6) | (7.7) | (2.6) | (13.5) | (37.5) |
| Exploration and evaluation acquisitions (Note 7) | (11.8) | (17.7) | (31.4) | (245.4) |
| Reclassification of deposit to asset acquisition | - | - | - | 15.0 |
| Net change in non-cash working capital (Note 16) | - | - | - | (0.2) |
| Cash Used in Investing Activities | (19.5) | (20.3) | (44.9) | (268.1) |
| Financing Activities | | | | |
| Dividends on common shares (Note 9) | (45.8) | (44.3) | (135.9) | (130.9) |
| Share issuance, net of costs | - | - | - | 276.9 |
| Common shares repurchased (Note 9) | (12.5) | (9.5) | (35.9) | (31.2) |
| Stock option exercise | - | (0.7) | - | (0.7) |
| Bank debt (Note 15b) | 0.5 | - | 0.5 | - |
| Financing costs | - | - | (0.3) | - |
| Net change in non-cash working capital (Note 16) | - | 0.6 | - | 0.6 |
| Cash From (Used in) Financing Activities | (57.8) | (53.9) | (171.6) | 114.7 |
| Increase (Decrease) in Cash and Cash Equivalents | (10.0) | 5.1 | (45.1) | 68.0 |
| Cash and Cash Equivalents, Beginning of Period | 10.0 | 96.9 | 45.1 | 34.0 |
| Cash and Cash Equivalents, End of Period | \$ - | \$ 102.0 | \$ - | \$ 102.0 |

See accompanying Notes to Interim Condensed Consolidated Financial Statements.

NOTES TO THE INTERIM CONDENSED 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

A) STATEMENT OF COMPLIANCE

These unaudited interim condensed consolidated financial statements (the “financial statements”) have been prepared in accordance with International Accounting Standard (“IAS”) 34, “Interim Financial Reporting”. Except for the changes noted below (Note 3), the Company has consistently applied the accounting policies to all periods presented in these financial statements. Certain information and disclosures normally included in the audited annual consolidated financial statements, prepared in accordance with International Financial Reporting Standards (“IFRS”), have been condensed or omitted. Accordingly, these financial statements should be read in conjunction with the audited annual consolidated financial statements for the year ended December 31, 2017.

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 authorized for issuance by the Company’s Audit Committee on October 29, 2018.

B) ESTIMATES

The timely preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenues and expenses during the period. Actual results may differ from these estimates.

In preparing these financial statements, the judgments made by management in applying the Company’s accounting policies and the key sources of estimation uncertainty were the same as those applied to the audited annual consolidated financial statements as at and for the year ended December 31, 2017.

3. CHANGES IN ACCOUNTING POLICIES

A) IFRS 15

The Company adopted IFRS 15, "Revenue from Contracts with Customers" on January 1, 2018. PrairieSky used the modified retrospective adoption approach to adopt the new standard. The Company reviewed its revenue streams and major contracts with customers using the IFRS 15 five-step model and there were no material changes to net earnings or the timing of royalty production revenue or other revenue recognized. Under this method, there was no effect to opening deficit from the application of IFRS 15 to revenue contracts in progress at January 1, 2018. The additional disclosures required by IFRS 15 are detailed in Note 11.

Revenue recognition policy:

PrairieSky receives royalties from third party development of petroleum and natural gas pursuant to lease agreements on its fee simple lands. PrairieSky also collects royalties on production from gross overriding royalty interests ("GORR") that are tied to an underlying mineral lease.

The continuation of a lease is typically dependent on the holder thereof continuing to produce hydrocarbons and maintaining the lease in good standing. Accordingly, PrairieSky's performance obligations with respect to production royalties are satisfied over time, as petroleum and natural gas are produced.

Royalty revenue from the sale of crude oil, natural gas liquids ("NGL") and natural gas is recognized as it accrues in accordance with the terms of the royalty agreement, which is generally in the month when the product is produced with production volumes primarily marketed with lessees' production. Revenue for royalty production that is taken-in-kind is recognized when the performance obligations are met, which is when control of the product is transferred to the buyer and legal title is transferred to the external party. Royalty 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 royalty agreements. An accrual is included in revenue and accounts receivable for amounts not received during the month of production based on historical trends, new wells on stream and current market prices. Differences between the estimates and actual amounts received are adjusted and recorded in the period when the actual amounts are received.

Other revenue is comprised of non-royalty production revenue, including revenue generated from lease rentals and mineral lease bonus consideration received when new leases are negotiated. The Company generates bonus consideration by leasing its mineral interests to exploration and production companies. Bonus consideration for new leases and lease rentals for the term of the initial lease ("primary term") are recognized as revenue when the lease agreement is executed, payment is determined to be collectible, and the Company has no obligation to refund the payment. When a lease is extended past the primary term, lease rental payments are due and recognized annually on the anniversary of the lease execution.

B) IFRS 9

The Company adopted IFRS 9, "Financial Instruments" on January 1, 2018. The transition to IFRS 9 had no material effect on the Company's financial statements.

IFRS 9 contains three principal classification categories for financial assets: measured at amortized cost, fair value through other comprehensive income ("FVOCI"), or fair value through profit or loss ("FVTPL"). The classification of financial assets under IFRS 9 is generally based on the business model in which a financial asset is managed and its contractual cash flow characteristics. IFRS 9 eliminates the previous IFRS 39 categories of held to maturity, loans and receivables and available for sale. Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never separated. Instead, the hybrid financial instrument as a whole is assessed for classification.

Impairment of financial assets: IFRS 9 replaces the “incurred loss” model in IAS 39 with an “expected credit loss” model. The new impairment model applies to financial assets measured at amortized cost, and contract assets and debt investments at FVOCI. Under IFRS 9, credit losses are recognized earlier than under IAS 39. See Note 15 for additional disclosure on the Company’s credit risk.

Cash and cash equivalents and accounts receivable and accrued revenue continue to be measured at amortized cost and are now classified as “amortized cost”. There was no change to the Company’s classification of accounts payable and accrued liabilities, bank debt and dividends payable which are classified as “other financial liabilities” and are measured at amortized cost. The Company has not designated any financial instruments as FVOCI or FVTPL, nor does the Company use hedge accounting.

4. RECENT ACCOUNTING PRONOUNCEMENTS

New Standards Issued Not Yet Adopted

On January 13, 2016, the IASB issued IFRS 16, “Leases” which replaces IAS 17 “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. Under the new standard, companies will recognize new assets and liabilities, bringing off-balance sheet leasing arrangements with a term of more than 12 months onto the balance sheet unless the underlying asset is of low value. The Company’s mineral leases are not within the scope of IFRS 16. 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.

5. ACCOUNTS RECEIVABLE AND ACCRUED REVENUE

| | As at September 30, 2018 | As at December 31, 2017 |
|---|-----------------------------|----------------------------|
| Trade receivables and accrued revenue | \$ 39.6 | \$ 39.0 |
| Royalty note receivable | 1.0 | 3.9 |
| Production and mineral taxes receivable | 0.5 | - |
| Interest receivable | - | 0.1 |
| | 41.1 | 43.0 |
| Allowance for doubtful accounts | (1.0) | - |
| | \$ 40.1 | \$ 43.0 |

Trade receivables and accrued revenue relate to lease and royalty production payments receivable. At September 30, 2018, the Company had a royalty note receivable of \$1.0 million outstanding (December 31, 2017 - \$3.9 million) which is receivable in equal monthly instalments over the remainder of 2018 bearing interest at four percent per annum.

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 September 30, 2018 | \$ 40.1 | \$ 40.0 | \$ - | \$ 0.1 |
| As at December 31, 2017 | \$ 43.0 | \$ 42.9 | \$ - | \$ 0.1 |

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 15 for further information about credit risk.

6. ROYALTY ASSETS, NET

| | As at September 30, 2018 | As at December 31, 2017 |
|---|-----------------------------|----------------------------|
| Cost | | |
| Balance, Beginning of Period | \$ 1,270.5 | \$ 1,141.2 |
| Asset acquisitions | 13.5 | 59.3 |
| Transfers from exploration & evaluation assets (Note 7) | 34.9 | 70.0 |
| Balance, End of Period | 1,318.9 | 1,270.5 |
| Accumulated Depletion, Depreciation and Amortization | | |
| Balance, Beginning of Period | (450.3) | (283.6) |
| Depletion, depreciation and amortization | (105.2) | (166.7) |
| Balance, End of Period | (555.5) | (450.3) |
| Net Book Value, End of Period | \$ 763.4 | \$ 820.2 |

For the three and nine month period ended September 30, 2018, royalty assets acquired totaled \$7.7 million (three months ended September 30, 2017 - \$2.6 million) and \$13.5 million (nine months ended September 30, 2017 - \$38.5 million), respectively, which are primarily acquisitions of fee land and various producing GORR acquisitions.

For the nine months ended September 30, 2017, assets acquired included an acquisition of a producing GORR on the SAGD thermal oil project at Lindbergh, Alberta (the "Lindbergh Acquisition") for \$34.7 million.

7. EXPLORATION AND EVALUATION ASSETS ("E&E")

| | As at September 30, 2018 | As at December 31, 2017 |
|--------------------------------------|-----------------------------|----------------------------|
| Cost | | |
| Balance, Beginning of Period | \$ 1,431.8 | \$ 1,185.5 |
| Asset acquisitions | 31.4 | 321.2 |
| Transfers to royalty assets (Note 6) | (34.9) | (70.0) |
| Land expiries | (0.9) | (4.9) |
| Balance, End of Period | \$ 1,427.4 | \$ 1,431.8 |

For the three and nine month periods ended September 30, 2018, the Company acquired \$11.8 million (three months ended September 30, 2017 - \$17.7 million) and \$31.4 million (nine months ended September 30, 2017 - \$261.2 million) in undeveloped land, respectively.

For the nine months ended September 30, 2017, the Company acquired \$215.2 million in E&E assets attributed to undeveloped drilling locations on current and future phases of the Lindbergh Acquisition.

8. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

| | As at September 30, 2018 | As at December 31, 2017 |
|---|-----------------------------|----------------------------|
| Trade payables | \$ 1.7 | \$ 1.7 |
| Production and mineral taxes payable | 2.8 | 5.3 |
| Accrued liabilities for cash settled share-based compensation | 4.6 | 8.4 |
| Other accrued liabilities | 3.7 | 1.6 |
| | \$ 12.8 | \$ 17.0 |

9. 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 September 30, 2018 | | As at December 31, 2017 | |
|---|-----------------------------------|-------------------------|-----------------------------------|-------------------------|
| | Number of Shares (millions) | Amount (\$ millions) | Number of Shares (millions) | Amount (\$ millions) |
| Common Shares Outstanding, Beginning of Period | 236.0 | \$ 3,334.3 | 228.0 | \$ 3,071.2 |
| Issued pursuant to bought deal offering | - | - | 9.2 | 288.9 |
| Share issue costs (net of \$3.2 million tax effect in 2017) | - | - | - | (8.8) |
| Issued pursuant to stock option plan (net of withholding tax) | - | - | 0.1 | 1.2 |
| Issued pursuant to an acquisition | - | - | 0.1 | 1.6 |
| Common shares repurchased | (1.3) | (18.5) | (1.4) | (19.8) |
| Common Shares Outstanding, End of Period | 234.7 | \$ 3,315.8 | 236.0 | \$ 3,334.3 |

NORMAL COURSE ISSUER BID (“NCIB”)

On April 30, 2018, the Company announced the approval of the renewal of its NCIB by the TSX. The NCIB allows the Company to purchase for cancellation up to a maximum of 1,750,000 common shares over a twelve-month period which commenced on May 4, 2018 and expires no later than May 3, 2019. PrairieSky allocated \$50.0 million to repurchase common shares under the NCIB over such twelve-month period. All common shares purchased under the NCIB are cancelled.

During the three month period ended September 30, 2018, the Company purchased for cancellation 514,200 common shares (three months ended September 30, 2017 - 333,200 common shares) at an average cost of \$24.19 per common share (three months ended September 30, 2017 - \$28.58 per common share) for total consideration of \$12.5 million (three months ended September 30, 2017 - \$9.5 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 \$5.2 million (September 30, 2017 - \$4.8 million) was charged to the deficit for the period.

During the nine month period ended September 30, 2018, the Company purchased for cancellation 1,311,300 common shares (nine months ended September 30, 2017 - 1,065,600 common shares) at an average cost of \$27.36 per common share (nine months ended September 30, 2017 - \$29.27) for total consideration of \$35.9 million (nine months ended September 30, 2017 - \$31.2 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 \$17.4 million (September 30, 2017 - \$16.2 million) was charged to the deficit.

DIVIDENDS

During the three month period ended September 30, 2018, PrairieSky declared dividends of \$45.8 million (three months ended September 30, 2017 - \$44.3 million) or \$0.1950 per common share (September 30, 2017 - \$0.1875) and paid dividends of \$45.8 million (three months ended September 30, 2017 - \$44.3 million) or \$0.1950 per common share (three months ended September 30, 2017 - \$0.1875).

During the nine months ended September 30, 2018, PrairieSky declared dividends of \$136.4 million (nine months ended September 30, 2017 - \$132.0 million) or \$0.5800 per common share (nine months ended September 30, 2017 - \$0.5575) and paid dividends of \$135.9 million (September 30, 2017 - \$130.9 million) or \$0.5775 per common share (nine months ended September 30, 2017 - \$0.5550).

On February 26, 2018, the Company increased its annual dividend by \$0.03 per common share to \$0.75 per common share per annum. On September 10, 2018, the Board of Directors declared a dividend of \$0.065 per common share or \$15.2 million payable on October 15, 2018 to common shareholders of record on September 28, 2018.

EARNINGS PER COMMON SHARE

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

| | Three months ended September 30 | | Nine months ended September 30 | |
|--|------------------------------------|---------|-----------------------------------|---------|
| | 2018 | 2017 | 2018 | 2017 |
| Net Earnings | \$ 28.5 | \$ 19.4 | \$ 73.4 | \$ 80.7 |
| Number of Common Shares: | | | | |
| Weighted Average Common Shares Outstanding - Basic | 235.0 | 236.4 | 235.4 | 236.6 |
| Effect of Dilutive Securities | 0.3 | 0.3 | 0.3 | 0.3 |
| Weighted Average Common Shares Outstanding - Diluted | 235.3 | 236.7 | 235.7 | 236.9 |
| Net Earnings per Common Share - Basic and Diluted | \$ 0.12 | \$ 0.08 | \$ 0.31 | \$ 0.34 |

10. 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 officer remains actively employed with the Company on the vesting date. RSUs vest evenly over a three-year period, provided the officer or employee 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:

| | Three months ended September 30 | | Nine months ended September 30 | |
|--|------------------------------------|---------------|-----------------------------------|---------------|
| | 2018 | 2017 | 2018 | 2017 |
| Compensation costs of transactions classified as equity-settled | \$ 0.4 | \$ 0.6 | \$ 1.4 | \$ 1.5 |
| Compensation costs (recovery) of transactions classified as cash-settled | (1.0) | 2.7 | (2.5) | 6.6 |
| Total share-based compensation expense (recovery) | \$ (0.6) | \$ 3.3 | \$ (1.1) | \$ 8.1 |

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

| | As at September 30, 2018 | As at December 31, 2017 |
|---|-----------------------------|----------------------------|
| Liability for unvested cash-settled plans | \$ 3.2 | \$ 10.5 |
| Liability for vested cash-settled plans | 2.6 | 2.9 |
| Liability for cash-settled plans | \$ 5.8 | \$ 13.4 |

As at September 30, 2018, \$4.6 million (December 31, 2017 - \$8.4 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 \$1.2 million (December 31, 2017 - \$5.0 million) is a long-term liability and is reported as 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, 2016 | 1,032.6 | 26.85 |
| Granted | 259.1 | 32.03 |
| Exercised | (520.9) | (27.39) |
| Forfeited | (13.8) | (29.94) |
| Issued and Outstanding, December 31, 2017 | 757.0 | 29.28 |
| Granted | 279.7 | 32.06 |
| Exercised | (4.8) | (22.55) |
| Forfeited | (33.7) | (29.39) |
| Issued and Outstanding, September 30, 2018 | 998.2 | 30.09 |

The weighted average share price on the dates that options were exercised was \$26.81 during the first nine months of 2018 (September 30, 2017 - \$32.98).

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

| | September 30, 2018 | September 30, 2017 |
|---|--------------------|--------------------|
| Risk free interest rate | 1.89% | 1.07% |
| Dividend yield | 2.34% | 2.25% |
| Expected volatility rate based on historical volatility | 34% | 34% |
| Forfeiture rate | 6.4% | 6.4% |
| Expected life | 5 years | 5 yrs |
| Weighted average grant price | \$32.06 | \$32.03 |
| Fair value per option on grant date | \$8.11 | \$7.87 |

The following table summarizes information regarding stock options outstanding at September 30, 2018:

| 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-\$25.90 | 279,301 | 2.25 | 22.98 | 131,818 | 22.94 | 3.78 |
| \$30.80-\$32.06 | 718,900 | 3.17 | 31.71 | 267,493 | 31.15 | 6.90 |

The following table summarizes information regarding stock options outstanding at December 31, 2017:

| 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-\$25.90 | 290,445 | 3.00 | 22.96 | 36,393 | 23.95 | 3.77 |
| \$30.80-\$32.03 | 466,597 | 3.18 | 31.46 | 113,915 | 30.81 | 6.04 |

For the three and nine month periods ended September 30, 2018, administrative expense includes \$0.4 million (three months ended September 30, 2017 - \$0.6 million) and \$1.4 million (nine months ended September 30, 2017 - \$1.5 million), respectively, 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> | September 30, 2018 | December 31, 2017 |
|--|---------------------------|--------------------------|
| Issued and Outstanding, Beginning of Period | 283.0 | 204.9 |
| Granted | 126.6 | 114.7 |
| Exercised | (80.6) | (43.9) |
| Forfeited | (3.4) | - |
| Units, in lieu of dividends | 7.6 | 7.3 |
| Issued and Outstanding, End of Period | 333.2 | 283.0 |

For the three and nine month periods ended September 30, 2018, the Company recorded a compensation recovery of \$0.7 million (three months ended September 30, 2017 - expense of \$1.9 million) and \$2.8 million (nine months ended September 30, 2017 - expense of \$4.2 million), respectively, related to outstanding PSUs. The market common share price used in the PSU fair value calculation at September 30, 2018 was \$22.69 (September 30, 2017 - \$31.93). 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> | September 30, 2018 | December 31, 2017 |
|--|---------------------------|--------------------------|
| Issued and Outstanding, Beginning of Period | 140.7 | 246.3 |
| Granted | 46.9 | 50.6 |
| Exercised | (80.3) | (132.5) |
| Forfeited | (10.9) | (26.6) |
| Units, in lieu of dividends | 1.9 | 2.9 |
| Issued and Outstanding, End of Period | 98.3 | 140.7 |

For the three and nine month periods ended September 30, 2018, the Company recorded compensation costs of \$0.1 million (three months ended September 30, 2017 - \$0.5 million) and \$0.6 million (nine months ended September 30, 2017 - \$1.6 million), respectively, related to outstanding RSUs. The market common share price used in the RSU fair value calculation at September 30, 2018 was \$22.69 (September 30, 2017 - \$31.93). 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 nine months ended September 30, 2018, 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> | September 30, 2018 | December 31, 2017 |
|--|---------------------------|--------------------------|
| Issued and Outstanding, Beginning of Period | 89.1 | 65.3 |
| Granted | 23.2 | 21.7 |
| Units, in lieu of dividends | 2.2 | 2.1 |
| Issued and Outstanding, End of Period | 114.5 | 89.1 |

For the three and nine month periods ended September 30, 2018, the Company recorded a compensation recovery of \$0.4 million (three months ended September 30, 2017 - expense of \$0.3 million) and \$0.3 million (nine months ended September 30, 2017 - expense of \$0.8 million), respectively related to outstanding DSUs. The market common share price used in the DSU fair value calculation at September 30, 2018 was \$22.69 (September 30, 2017 - \$31.93).

11. REVENUES

The Company's royalty production revenue is determined pursuant to the terms of the royalty agreements. The transaction price for crude oil, NGL and natural gas is based on the commodity price in the month of production, adjusted for quality, location, allowable deductions, if any, or other factors. Commodity prices are based on market indices that are determined on a monthly or daily basis.

Royalty production payments are generally received two months after the crude oil, NGL, and natural gas are produced. Royalty revenues that are taken-in-kind are typically collected on the 25th day of the month following production. Lease rental revenue for the entire primary term is recorded when the lease is executed. Lease rental revenue for any subsequent period is recorded as due which is generally annually on the anniversary of the lease extension. Both the amount and timing of bonus consideration revenue can vary significantly from period to period as it is recorded when a new lease is executed and relates to the unique circumstances of each lease transaction.

| Royalty Revenue by Product | Three months ended September 30 | | Nine months ended September 30 | |
|-----------------------------------|--|----------------|---|-----------------|
| | 2018 | 2017 | 2018 | 2017 |
| Crude Oil | \$ 55.4 | \$ 39.5 | \$ 156.7 | \$ 134.4 |
| NGL | 8.6 | 6.0 | 25.6 | 21.3 |
| Natural Gas | 7.4 | 8.7 | 23.3 | 41.0 |
| | 71.4 | 54.2 | 205.6 | 196.7 |
| Other Revenue | | | | |
| Lease Rental Income | \$ 1.2 | \$ 1.6 | \$ 5.6 | \$ 7.7 |
| Bonus Consideration | 5.3 | 15.5 | 10.1 | 48.0 |
| Other Income | 0.2 | 0.4 | 0.9 | 1.8 |
| | 6.7 | 17.5 | 16.6 | 57.5 |
| Total Revenues | \$ 78.1 | \$ 71.7 | \$ 222.2 | \$ 254.2 |

| Revenues by Classification | Three months ended September 30 | | Nine months ended September 30 | |
|-----------------------------------|--|----------------|---|-----------------|
| | 2018 | 2017 | 2018 | 2017 |
| Fee Lands | \$ 50.4 | \$ 41.1 | \$ 148.8 | \$ 148.1 |
| GORR Interests | 21.0 | 13.1 | 56.8 | 48.6 |
| Royalty Revenue | 71.4 | 54.2 | 205.6 | 196.7 |
| Other Revenue | 6.7 | 17.5 | 16.6 | 57.5 |
| Total Revenues | \$ 78.1 | \$ 71.7 | \$ 222.2 | \$ 254.2 |

12. ADMINISTRATIVE EXPENSES

| | Three months ended September 30 | | Nine months ended September 30 | |
|-------------------------------------|------------------------------------|---------------|-----------------------------------|----------------|
| | 2018 | 2017 | 2018 | 2017 |
| Salaries and benefits | \$ 3.3 | \$ 3.3 | \$ 10.3 | \$ 10.4 |
| Share-based compensation (recovery) | (0.6) | 3.3 | (1.1) | 8.1 |
| Office expense | 1.0 | 1.0 | 3.4 | 2.5 |
| Public company expense | 0.2 | 0.2 | 1.2 | 1.2 |
| Information technology and other | 0.7 | 0.6 | 2.0 | 1.4 |
| Administrative expenses | \$ 4.6 | \$ 8.4 | \$ 15.8 | \$ 23.6 |

13. INCOME TAXES

| | Three months ended September 30 | | Nine months ended September 30 | |
|--------------------------------|------------------------------------|---------------|-----------------------------------|----------------|
| | 2018 | 2017 | 2018 | 2017 |
| Current tax expense (recovery) | \$ 5.6 | \$ (0.7) | \$ 17.9 | \$ 7.2 |
| Deferred tax expense | 2.5 | 1.7 | 5.0 | 5.0 |
| Income tax expense | \$ 8.1 | \$ 1.0 | \$ 22.9 | \$ 12.2 |

14. 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 15), 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 | As at |
|----------------------|--------------------|-------------------|
| | September 30, 2018 | December 31, 2017 |
| Shareholders' equity | \$ 2,622.5 | \$ 2,720.0 |
| Working capital | 10.6 | 45.7 |

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.

15. 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. Bank debt bears interest at a floating market rate with applicable variable margins, and accordingly the fair market value approximates the carrying amount.

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 global and regional factors, including levels of supply and demand, weather and geopolitical factors. 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.

The Company's royalty note receivable (Note 5) earns interest at a fixed rate. Bank debt bears interest at a floating market rate with applicable variable margins.

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 September 30, 2018, there was one counterparty whose accounts receivable individually accounted for more than 10% of the total accounts receivable balance. The maximum credit risk exposure associated with accounts receivable and accrued revenue is the total carrying value. For the nine months ended September 30, 2018, the Company has provided an allowance for doubtful accounts of \$1.0 million (September 30, 2017 - nil) calculated using an expected credit loss assessment for specifically identifiable customer balances which are assessed to have credit risk exposure.

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 \$224.5 million.

The timing of expected cash outflows relating to bank debt of \$0.5 million, accounts payable and accrued liabilities of \$12.8 million, income tax payable of \$2.5 million, and dividend payable of \$15.2 million is less

than one year. Included in accounts payable and accrued liabilities is \$2.6 million related to vested cash settled DSUs which may or may not be paid in the next year.

On May 15, 2018, the Company entered into a \$200 million extendible revolving credit facility (the "Revolving Facility"), with a permitted increase to \$250 million, and renewed the \$25 million extendible operating credit facility (the "Operating Facility", and together with the Revolving Facility, the "Credit Facility"), with a syndicate of Canadian chartered banks.

The Credit Facility includes borrowing options of Canadian prime rate-based advances, U.S. base rate advances, LIBOR loans, bankers' acceptances and letters of credit, and will bear 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 and does not have a borrowing base restriction. The Revolving Facility and the Operating Facility are each for three-year terms maturing on May 15, 2021 and, subject to certain requirements, are extendible annually. The credit facility has three financial covenants, whereby the Company's ratio of adjusted consolidated senior debt to EBITDA will not exceed 3.5:1.0, adjusted consolidated total debt to EBITDA will not exceed 4.0:1.0, and the adjusted consolidated total debt to capitalization ratio will not exceed 55%. The EBITDA used in the covenant calculation is adjusted for non-cash items, interest expense and income taxes. As at September 30, 2018, the Company was compliant with all covenants provided for in the lending agreement.

As at September 30, 2018, the Company had \$0.5 million in bank debt outstanding on the Operating Facility (December 31, 2017 - nil). The Revolving Facility remains undrawn. The effective interest rate for the three and nine months ended September 30, 2018 was 4.2% (three and nine months ended September 30, 2017 - nil).

16. SUPPLEMENTARY INFORMATION

NET CHANGE IN NON-CASH WORKING CAPITAL

| | Three months ended September 30 | | Nine months ended September 30 | |
|--|------------------------------------|---------|-----------------------------------|---------|
| | 2018 | 2017 | 2018 | 2017 |
| Source (use) of cash: | | | | |
| Accounts receivable and accrued revenue | \$ (1.5) | \$ 11.2 | \$ 0.2 | \$ 8.0 |
| Prepays | 0.4 | 0.5 | (0.6) | (0.2) |
| Accounts payable and accrued liabilities | 0.1 | 2.1 | (0.8) | (2.0) |
| Income tax payable | 1.3 | (0.7) | (8.6) | 6.9 |
| Changes in non-cash working capital | \$ 0.3 | \$ 13.1 | \$ (9.8) | \$ 12.7 |
| Related to operating activities | 0.3 | 12.5 | (9.8) | 12.3 |
| Related to investing activities | - | - | - | (0.2) |
| Related to financing activities | - | 0.6 | - | 0.6 |
| Changes in non-cash working capital | \$ 0.3 | \$ 13.1 | \$ (9.8) | \$ 12.7 |

SUPPLEMENTARY CASH FLOW INFORMATION

| | Three months ended September 30 | | Nine months ended September 30 | |
|-------------------|------------------------------------|------|-----------------------------------|------|
| | 2018 | 2017 | 2018 | 2017 |
| Taxes Paid | \$ 4.5 | \$ - | \$ 26.7 | \$ - |
| Interest Paid | 0.2 | 0.1 | 0.3 | 0.1 |
| Interest Received | 0.1 | 0.4 | 0.3 | 0.9 |

CORPORATE INFORMATION

BOARD OF DIRECTORS

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

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

TSX Trust Company

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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