
Management Discussion of Financial Results Q2 2016

White Owl Energy Services Inc. (“White Owl” or the “Company”) is a private company and therefore is not required to prepare and file Management Discussion and Analysis (“MD&A”) in accordance with National Instrument 51-102 – Continuous Disclosure Obligations, which requires public companies to prepare MD&A in accordance with Form 51-102F1 of National Instrument 51-102 or Items 303 of Regulation S-K or Regulation S-B under applicable United States securities laws. **Therefore, this discussion may not include all the information that might otherwise be required or expected thereunder. The following discussion of financial results does not constitute MD&A for the purposes of Canadian or United States securities laws or any other laws.** This discussion called the Management Discussion of Financial Results (“MDFR”) is being provided to help shareholders, lenders and other stakeholders meet their needs for additional information beyond what is provided in the financial statements and notes.

This MDFR of financial results is based on information available to August 16, 2016 and should be read in conjunction with White Owl’s unaudited condensed Financial Statements for the three and six months ended June 30, 2016 and audited Financial Statements for the year ended December 31, 2015. The Financial Statements and comparative information have been prepared in accordance with International Financial Reporting Standards (“IFRS”).

All amounts are in Canadian dollars unless otherwise noted.

CORPORATE OVERVIEW

White Owl is an oilfield service company providing oilfield waste processing and disposal services to exploration and production companies with unconventional oil and gas operations throughout North Dakota. With an expanding network of produced water and flow-back disposal facilities, White Owl is well positioned to continue developing its assets to handle additional oilfield fluids and solids processing, recovery and disposal in North Dakota.

A description of the Company’s key business segments follows.

Produced Water and Waste Water Disposal

The Company provides produced water and “frac” water disposal services through a network of four Class 2 salt water disposal (“SWD”) wells in the state of North Dakota and may expand to other markets in the future. These Class 2 SWD wells and facilities are situated at Ross, New Town, Watford and Alexander and the Company is currently developing additional facilities in North Dakota at Epping, Tioga (through a joint venture arrangement), Johnson’s Corner, Van Hook and Killdeer.

Oilfield Waste Processing

Liquid waste is generated as a result of drilling, completions and production-related activities. White Owl’s planned oilfield treatment plants will separate fluids into three components: recoverable oil, waste water and residual solids. Recovered oil will be sold while separated solids will be processed and transported to third party landfills in North Dakota. It is the Company’s intention to eventually provide oilfield waste processing and disposal services at its select Class 2 SWD locations with treatment permits across North Dakota.

Class 1 Non-Hazardous Waste Water Disposal

The Company expects to receive a permit in 2016 for the processing and disposal of Class 1 non-hazardous waste water at the Killdeer location from the State of North Dakota with oversight by the US Environmental Protection Agency. A variety of industries including midstream oil and gas, landfills and mines produce Class 1 non-hazardous waste water which must be disposed of at a Class 1 non-hazardous waste water facility. There are currently no commercial Class 1 non-hazardous waste water facilities in North Dakota.

Within its markets, the Company differentiates itself by:

- Operating with the highest levels of responsible environmental, health and safety stewardship.
- Providing a high level of customer service including a focus on expedited truck unload times.
- Operation, design and construction of facilities that provide efficient and safe separation of fluids.
- Acquiring and integrating strategically-located SWD plants into its expanding network.
- Vertically integrating into complementary, value-add, and higher margin services.

OPERATIONAL AND FINANCIAL HIGHLIGHTS

White Owl has an inventory of new projects which will expand its service area with existing customers in the North Dakota marketplace, although the Company's business plan has been tempered somewhat by the slowdown in drilling activity related to the share decline in oil prices over the past 12 to 18 months. The Company continues to invest operating cash flow in plant improvements while additional sources of capital will be needed to fund new projects.

Financial and operating results

	Three months ended June 30		Six months ended June 30	
<i>(\$000's except for volumes)</i>	2016	2015	2016	2015
Volumes received (barrels)	2,892,248	2,674,342	5,448,146	5,186,808
Revenue	2,693	2,651	4,986	5,233
Operating expenses	1,376	1,450	2,710	3,451
Operating income⁽¹⁾	1,317	1,201	2,276	1,782
General and administrative	370	498	727	939
EBITDA ⁽¹⁾	947	703	1,549	843
Other income and expenses				
Interest income	-	(1)	(1)	(2)
Depreciation and amortization	281	298	625	593
Finance costs	281	409	774	779
Share based payments	79	129	157	253
Foreign exchange losses (gain)	-	36	31	(163)
Gain on debt extension	-	-	(269)	-
Loss on disposal of assets	-	-	44	-
Net income (loss)	306	(168)	188	(617)

⁽¹⁾ Refer to "Non-GAAP Measures" for additional information.

The operational and financial highlights for the second quarter of 2016 are as follows:

- EBITDA in the second quarter totaled \$947,000, the highest quarterly performance achieved by the Company to date and an increase of \$244,000 or 35% from the second quarter of 2015. The increase in EBITDA was a result of reductions in G&A, an increase in total disposal volumes and a stronger US dollar. Unit prices received for disposal were lower due to more competitive market conditions.
- Construction of the Tioga SWD has commenced and the facility is expected to be commissioned late in the third quarter of 2016. White Owl will contribute the location, permits, engineering design and certain equipment from the Alexander site to the joint venture (the "Tioga JV") and will hold a 32% interest in the Tioga JV. The two other joint venture partners will contribute a total of US\$2.5 million for their combined 68% interest. An operating committee governs the Tioga JV with an appointee from each of

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the Tioga JV partners. Decisions of the operating committee require unanimous consent of the appointees.

Revenue and operating income by facility

	Three months ended June 30		Six months ended June 30	
(\$000's)	2016	2015	2016	2015
Revenue				
New Town	1,313	1,333	2,296	2,456
Watford	1,046	666	1,855	1,344
Ross	298	613	726	1,376
Alexander	36	39	109	57
	2,693	2,651	4,986	5,233
Operating income ⁽¹⁾				
New Town	636	733	1,080	988
Watford	637	257	1,023	426
Ross	77	278	240	611
Alexander	(33)	(67)	(67)	(243)
	1,317	1,201	2,276	1,782

⁽¹⁾ Refer to "Non-GAAP Measures" for additional information.

Second quarter 2016 operating income at the New Town facility was lower than the prior year due to lower realized prices related to more competitive market conditions, partially offset by a 12% increase in disposal volumes and a stronger US dollar. Operating income for the six months ended June 30, 2016 was also affected by pricing (market conditions), the receipt of a \$117,000 reimbursement for tank cleaning costs in the first quarter of 2016 and slightly higher maintenance costs.

Operating income for the three and six months ended June 30, 2016 at the Watford facility was higher than the same periods in 2015 due to a 75% and 60% increase respectively in plant throughput and a stronger US dollar. The recent expansion at the Watford City plant enabled it to handle the higher volumes. The Watford City plant is central to some of the most productive acreage in the Bakken play.

Operating income for the three and six months ended June 30, 2016 at the Ross facility was lower than in the same periods in the prior year due to a 55% and 48% decrease, respectively, in plant volumes and lower realized prices partially offset by lower plant operating costs and a stronger US dollar. The Ross plant is located on the edges of the Bakken tier one acreage where there is little drilling and completion activity. Recent activity in the area may result in a stronger second half financial performance at this facility.

Operations at the Alexander facility were suspended in June 2016 due low demand for disposal services in the area.

General and administrative (“G&A”) expenses

	Three months ended June 30		Six months ended June 30	
(\$000's)	2016	2015	2016	2015
Salaries and management consulting	228	263	460	511
Professional fees	34	115	71	192
Travel and related expenses	58	60	100	114
General office expenses	50	60	96	122
	370	498	727	939

G&A expenses in the three and six months ended June 30, 2016 were lower than the prior year due to the elimination of variable compensation incentive for 2016 and lower professional fees. The reductions in compensation were made in response to weak industry conditions.

Depreciation and amortization

Depreciation and amortization for the three and six months ended June 30, 2016 was \$281,000 and \$625,000 compared to \$298,000 and \$593,000 for the same periods in 2015.

Finance costs

	Three months ended June 30		Six months ended June 30	
(\$000's)	2016	2015	2016	2015
Interest on term loan	219	211	454	426
Interest on long-term debt	25	23	51	46
Cost of share repurchase obligation settlement	-	-	139	-
Loan fees	-	32	0	32
Accretion of long-term debt	29	27	60	54
Accretion of share repurchase obligations	-	96	55	194
Accretion of asset retirement obligations	7	5	13	11
Bank charges and other	1	15	2	16
	281	409	774	779

Finance costs in the second quarter of 2016 were lower than the second quarter of 2015 due to the settlement of the share repurchase obligations in the first quarter of 2016 partially offset by the impact of a stronger US dollar.

Foreign exchange losses (gains)

The Company recorded foreign exchange losses of \$31,000 during the six months ended June 30, 2016 compared to foreign exchange gains of \$163,000 for the same period in 2015. The gains and losses primarily relate to the impact of changes in exchange rates on US dollar cash balances and short-term intercompany loans. The average exchange rate for the three and six months ended June 30, 2016 was 1.29 USD/CDN and 1.33 USD/CDN compared to 1.23 USD/CDN and 1.24 USD/CDN during the same periods in 2015.

Share based payments

During the six months ended June 30, 2016, the Company recorded share based payments of \$157,000 compared to \$253,000 for the same period in 2015. Share based payments relate to the cost of stock options issued to management, employees and directors of the Company.

SUMMARY OF QUARTERLY RESULTS

	2016		2015				2014	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Revenue	\$ 2,693	\$ 2,293	\$ 2,816	\$ 2,859	\$ 2,651	\$ 2,582	\$ 2,688	\$ 1,442
EBITDA ⁽¹⁾	947	62	88	56	78	10	34	18
Net income (loss)	\$ 306	\$ (118)	\$ (10,937)	\$ (200)	\$ (168)	\$ (449)	\$ (366)	\$ (287)

⁽¹⁾ Refer to "Non-GAAP Measures" for additional information.

The quarterly financial results reflect the operations of the New Town and Alexander facilities from September 22, 2014. The Company recognized an impairment of \$11.0 million in the fourth quarter of 2015.

EBITDA in the second quarter of 2016 was higher than the prior quarter due to a 13% increase in disposal volumes and higher revenue for recovered oil.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity risk is the risk that the Company will not be able to meet financial obligations at the point at which they are due. The Company manages its liquidity risk through cash and debt management combined with equity financing when available. Management's assessment of the Company's liquidity reflects estimates, assumptions and judgments relating to current market conditions. The Company has funded its operations, acquisitions and capital program with a combination of equity, bank debt and vendor take back notes. To manage its liquidity and capital resources, the Company ensures that adequate sources of capital are available to fund capital investments, while ensuring that sufficient operating cash flow is available to sustain and grow the operating business.

As at June 30, 2016, the Company had negative working capital of \$11.7 million and an accumulated deficit of \$12.7 million. These factors indicate the existence of material uncertainties which may cast significant doubt about the Company's ability to continue as a going concern. The ability of the Company to continue as a going concern and realize the carrying value of its assets and discharge its liabilities when due is dependent on achieving future profitable operations. There is no certainty that the Company will achieve profitable operations in the future due to factors such as commodity prices, industry activity levels in the regions in which the Company operates, changes by competitors, successfully raising capital for acquisition and development opportunities and successful implementation of the Company's business plan.

The consolidated financial statements do not include any adjustments to the amounts and classifications of assets and liabilities, and reported revenues and expenses, that might be necessary should the Company be unable to continue as a going concern, and therefore, be required to realize its assets and discharge its liabilities other than in the normal course of business and at carrying amounts different from those reflected in the accompanying consolidated financial statements. Any such adjustments could be material.

Cash provided by (used in) operations

	Three months ended June 30		Six months ended June 30	
<i>(\$000's)</i>	2016	2015	2016	2015
Cash provided by operating activities before change in working capital	702	423	903	325
Change in working capital	(565)	(174)	(41)	293
Cash provided by operations	137	249	862	618

Cash flow from operating activities before changes in working capital in the second quarter of 2016 was higher than the same period in the prior year due to reductions in G&A, an increase in total disposal volumes and a stronger US dollar. Unit prices received for disposal were lower due to more competitive market conditions. The increase in working capital in the second quarter of 2016 is primarily the result of an increase in accounts receivable due to higher revenues in the second quarter.

Investing activities

	Three months ended June 30		Six months ended June 30	
<i>(\$000's)</i>	2016	2015	2016	2015
Capital expenditures	342	769	1,716	1,397

The following are highlights of the capital projects completed during the six months ended June 30, 2016:

- Growing customer demand in the Watford City area led to an expansion project at the Watford SWD facility. The facility expansion was commissioned on schedule in April 2016. Total spending on this project was \$1,692,000, of which \$1,379,000 was spent in the six months ended June 30, 2016.

In 2016, the Company will incur ongoing costs related to regulatory and design work for development projects, although these activities have been substantially curtailed due to market conditions.

Financing activities

Share Capital

In February 2016, the Company terminated the share repurchase obligations that required the Company to repurchase 2,000,000 shares of the Company at US\$0.50 and 4,000,000 shares at US\$0.88 in exchange for a payment of \$139,000, release of funds held in escrow and termination of the Company's rights to repurchase these shares. The Company recorded an increase in share capital of \$5,511,000 and a settlement expense of \$139,000.

	Common shares	Preferred shares	Total shares outstanding
Balance, December 31, 2015 and June 30, 2016	26,758,788	26,468,592	53,227,380

Share Options

There were 2,539,000 share options outstanding as of June 30, 2016 with a weighted average exercise price of \$0.53.

Term Loan and Operating Loan

The term loan is a non-revolving, reducing demand facility at an annual interest rate of US prime plus 1.75%. The Company is required to make monthly interest payments as well as total principal payments of US\$200,000 during the six months ending December 31, 2016. Principal payments of \$246,000 (US\$183,000) were made during the six months ended June 30, 2016 (2015 - \$477,000 (US\$386,000)). The remaining balance at December 31, 2016 will be repaid over an eight-year amortization period. Blended monthly principal and interest payments of US\$151,000 will start on January 31, 2017 if the US prime rate remains unchanged from current rates. The loan is subject to annual review with the next review scheduled for June 2017.

The operating loan is a US\$1,000,000 facility and is reduced by outstanding letters of credit of \$54,000. There are no amounts drawn on the operating line at June 30, 2016 (December 31, 2015 – nil).

Under the loan agreement for the term and operating loans, the Company is required to maintain a minimum Debt Service Coverage Ratio of 1.1 to 1 until September 30, 2016 and 1.25 to 1 thereafter. The Debt Service Coverage Ratio is calculated as follows:

$$\text{Debt Service Coverage Ratio} = \frac{\text{Earnings before interest, depreciation, taxes and amortization}}{\text{Debt service obligations}}$$

The Debt Service Coverage Ratio at June 30, 2016 was 1.91 (December 31, 2015 – 1.68). The ratio is calculated based on the trailing three quarters at June 30, 2016 and will be based on the trailing four quarters in the future.

OUTLOOK

Market conditions in North Dakota continue to be challenging as the vast majority of activity remains focused in McKenzie and Dunn Counties - the heart of the Bakken. The fact that we have commenced construction of our Tioga SWD with capital coming from JV partners has given us the confidence to move forward on the development of our Epping and Johnson's Corner SWD projects. Again we will attempt to source third party capital to help fund these developments.

As you can see from the second quarter results, White Owl's injection volumes and EBITDA increased meaningfully over the first quarter of 2016 and the same quarter in 2015. This performance along with the modest improvement in oil prices and broader industry conditions, has encouraged us to seek outside capital. As outlined in the private placement financing information previously provided to you, we anticipate being able to proceed with a \$5.0 million equity financing in September once specific financing terms and conditions are finalized.

We continue to position ourselves for an expected recovery in oil prices, albeit there is continuing uncertainty on timing. We remain confident that the North Dakota marketplace can provide us with suitable growth opportunities and we continue to pursue innovative concepts and ideas in the water handling and SWD space.

NON-GAAP MEASURES

Operating income and Earnings Before Interest, Taxes, Depreciation and Amortization ("EBITDA") are not recognized measures under IFRS. Management believes that operating income is a useful measure of financial performance, cost control and operating efficiency. Management believes that in addition to net income, EBITDA is a useful supplemental measure of financial performance as it provides an indication of results generated by the Company's principal business activities prior to consideration of non-cash charges. Operating income and EBITDA are commonly accepted measures in the industry which is useful for knowledgeable investors for comparison purposes. Operating income is calculated as revenue from oilfield waste disposal services less operating expenses. EBITDA is calculated as operating income less general and administrative expenses. White Owl's determination of operating income and EBITDA may not be comparable to that reported by other companies.

FORWARD-LOOKING INFORMATION

This discussion contains forward-looking information, which is disclosure regarding possible events, conditions or financial performance that is based on assumptions about future courses of action and economic conditions. Such forward-looking information may be identified by words such as "anticipate", "will", "intend", "could", "should", "may", "might", "expect", "forecast", "plan", "potential", "project", "assume", "contemplate", "believe", "budget", "shall", "continue", "milestone", "target", "vision", and similar terms or the negative thereof or other comparable terminology.

The forward-looking information in this discussion is subject to significant risks and uncertainties and is based on a number of material factors and assumptions which may prove to be incorrect, including, but not limited to, the following: corporate strategy; general market conditions; the oil and natural gas industry; activity levels in the oil and gas sector, including market fundamentals, drilling levels, commodity prices for oil and natural gas; demand for the Company's services; operational performance; expansion strategy; debt service; capital expenditures; completion of facilities; the impact of new facilities on the Company's financial and operational performance; future capital needs; and access to capital through equity market and debt markets.

The forward-looking information relies on material assumptions and known and unknown risks and uncertainties, certainty of which are beyond the Company's control. Such risks and uncertainties include, without limitation, the impact of general economic conditions in the United States, Canada and globally; industry conditions; the Company's ability to increase its market share; volatility of commodity prices; delays resulting from an inability to obtain regulatory approvals; an inability to access sufficient capital from internal and external sources; changes in laws and regulations and changes in how they are interpreted and enforced; environmental risks; increased competition; and the lack of qualified personnel or management. Readers are cautioned that the foregoing list of factors and risks are not exhaustive. The Company's actual results, performance or achievements could differ materially from those expressed in, or implied by, the forward-looking information and, accordingly, no assurances can be given that any of the events anticipated by the Forward-Looking Statements will transpire or occur. Although the Company has attempted to identify important risks and factors that could cause actual actions, events or results to differ materially from those described, there may be other factors and risks that cause actions, events or results not anticipated, estimated or intended. Accordingly, readers should not place any undue reliance on the forward-looking information, as such information may not be appropriate for other purposes.

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