STEP energy services

TSX STEP

# Condensed Consolidated Interim

# Financial Statements

As at and for the three months ended March 31, 2020

# STEP ENERGY SERVICES LTD.

## CONDENSED CONSOLIDATED INTERIM STATEMENTS OF FINANCIAL POSITION

| As at<br>Unaudited (in thousands of Canadian dollars) | Notes | | March 31, 2020 | | December 31, 2019 |
|---|---|---|---|---|---|
| ASSETS | | | | | |
| Current Assets | | | | | |
| Cash and cash equivalents | | $ | 36,875 | $ | 7,267 |
| Trade and other receivables | 14 | | 143,391 | | 104,723 |
| Income tax receivable | | | 8,320 | | 8,702 |
| Inventory | 3 | | 27,384 | | 28,402 |
| Prepaid expenses and deposits | | | 6,253 | | 8,418 |
| Assets held for sale | 4 | | 1,480 | | 1,364 |
| | | | 223,703 | | 158,876 |
| Property and equipment | 5,6 | | 452,899 | | 507,045 |
| Right-of-use assets | | | 19,710 | | 18,793 |
| Intangible assets | | | 1,280 | | 1,325 |
| | | $ | 697,592 | $ | 686,039 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | |
| Current Liabilities | | | | | |
| Trade and other payables | 14 | $ | 107,507 | $ | 77,065 |
| Income tax payable | 14 | | 435 | | 86 |
| Current portion of lease obligations | | | 9,679 | | 9,569 |
| | | | 117,621 | | 86,720 |
| Deferred tax liabilities | | | 12,447 | | 29,015 |
| Lease obligations | | | 10,596 | | 9,452 |
| Other liabilities | 10 | | 160 | | 611 |
| Loans and borrowings | 7 | | 264,508 | | 237,418 |
| | | | 405,332 | | 363,216 |
| Shareholders' equity | | | | | |
| Share capital | 9 | | 429,060 | | 428,817 |
| Contributed surplus | | | 32,634 | | 32,198 |
| Accumulated other comprehensive income | | | 26,813 | | 5,852 |
| Deficit | | | (196,247) | | (144,044) |
| | | | 292,260 | | 322,823 |
| | | $ | 697,592 | $ | 686,039 |

See accompanying notes to the condensed consolidated interim financial statements

Note 2 – Future Operations
Note 8 – Commitments
Note 15 – Contingencies and Provisions
Note 17 – Subsequent Event

# STEP ENERGY SERVICES LTD.

## CONDENSED CONSOLIDATED INTERIM STATEMENTS OF NET LOSS AND OTHER COMPREHENSIVE LOSS

| For the three months ended March 31,<br>Unaudited (in thousands of Canadian dollars, except per share amounts) | Notes | | 2020 | | 2019 |
|---|---|---|---|---|---|
| Revenue | | $ | 194,369 | $ | 176,469 |
| Operating expenses | 12 | | 188,052 | | 167,339 |
| Gross profit | | | 6,317 | | 9,130 |
| Selling, general and administrative expenses | 12 | | 9,588 | | 8,843 |
| Results from operating activities | | | (3,271) | | 287 |
| Finance costs | 13 | | 4,460 | | 3,253 |
| Foreign exchange (gain) loss | | | 2,617 | | (1,265) |
| Gain on disposal of property and equipment | | | (830) | | (672) |
| Amortization of intangible assets | | | 128 | | 1,774 |
| Foreign exchange forward contract loss | | | - | | 383 |
| Impairment of property and equipment | 5,6 | | 58,750 | | - |
| Loss before income tax | | | (68,396) | | (3,186) |
| Income tax expense (recovery) | | | | | |
| Current | | | 1,077 | | 1,283 |
| Deferred | | | (17,270) | | (3,867) |
| | | | (16,193) | | (2,584) |
| Net loss | | | (52,203) | | (602) |
| Other comprehensive (loss) income | | | | | |
| Foreign currency translation gain (loss) | | | 20,961 | | (8,793) |
| Total comprehensive loss | | $ | (31,242) | $ | (9,395) |
| Loss per share: | | | | | |
| Basic | 11 | $ | (0.78) | $ | (0.01) |
| Diluted | 11 | $ | (0.78) | $ | (0.01) |

See accompanying notes to the condensed consolidated interim financial statements

# STEP ENERGY SERVICES LTD.

## CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CHANGES IN EQUITY

| Unaudited (in thousands of Canadian dollars) | Notes | Share capital | Contributed surplus | Accumulated other comprehensive (loss) income | Retained earnings (deficit) | Total |
|---|---|---|---|---|---|---|
| Balance at January 1, 2019 | | $ 426,494 | $ 29,447 | $ 22,670 | $ (7) | $ 478,604 |
| Impact of change in accounting policy | | - | - | - | (154) | (154) |
| Net loss for the period | | - | - | - | (602) | (602) |
| Foreign currency translation loss | | - | - | (8,793) | - | (8,793) |
| Share-based compensation | 10 | - | 1,180 | - | - | 1,180 |
| Exercise of equity share-based compensation | 9,10 | 275 | (275) | - | - | - |
| Balance at March 31, 2019 | | $ 426,769 | $ 30,352 | $ 13,877 | $ (763) | $ 470,235 |
| | | | | | | |
| Balance at January 1, 2020 | | $ 428,817 | $ 32,198 | $ 5,852 | $ (144,044) | $ 322,823 |
| Net loss for the period | | - | - | - | (52,203) | (52,203) |
| Foreign currency translation loss | | - | - | 20,961 | - | 20,961 |
| Share-based compensation | 10 | - | 679 | - | - | 679 |
| Exercise of equity share-based compensation | 9,10 | 243 | (243) | - | - | - |
| **Balance at March 31, 2020** | | **$ 429,060** | **$ 32,634** | **$ 26,813** | **$ (196,247)** | **$ 292,260** |

See accompanying notes to the condensed consolidated interim financial statements

STEP ENERGY SERVICES LTD.

## CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CASH FLOWS

| For the three months ended March 31,<br>Unaudited (in thousands of Canadian dollars) | Notes | | 2020 | | 2019 |
|---|---|---|---|---|---|
| Operating activities: | | | | | |
| Net loss | | $ | (52,203) | $ | (602) |
| Adjusted for the following: | | | | | |
| Depreciation and amortization | 5 | | 27,141 | | 26,841 |
| Share-based compensation | 10 | | (940) | | 1,263 |
| Unrealized foreign exchange loss (gain) | | | 2,328 | | (1,562) |
| Gain on disposal of property and equipment | | | (830) | | (672) |
| Foreign exchange forward contract loss | | | - | | 383 |
| Impairment of property and equipment | 5,6 | | 58,750 | | - |
| Finance costs | 13 | | 4,460 | | 3,253 |
| Income tax recovery | | | (16,193) | | (2,584) |
| Cash finance costs paid | | | (5,416) | | (5,315) |
| Income taxes paid | | | (15) | | (4,014) |
| Changes in non-cash working capital from operating activities | | | 252 | | (225) |
| Net cash provided by operating activities | | | 17,334 | | 16,766 |
| Investing activities: | | | | | |
| Purchase of property and equipment | 5 | | (11,694) | | (10,347) |
| Proceeds from disposal of equipment and vehicles | | | 2,537 | | 679 |
| Changes in non-cash working capital from investing activities | | | (2,246) | | (276) |
| Net cash used in investing activities | | | (11,403) | | (9,944) |
| Financing activities: | | | | | |
| Issuance of loans and borrowings | 7 | | 24,627 | | 1,799 |
| Repayment of obligations under finance lease | | | (1,846) | | (1,752) |
| Settlement of foreign exchange forward contracts | | | - | | (338) |
| Net cash provided by (used in) financing activities | | | 22,781 | | (291) |
| Impact of exchange rate changes on cash | | | 896 | | 145 |
| Increase in cash and cash equivalents | | | 29,608 | | 6,676 |
| Cash and cash equivalents, beginning of period | | | 7,267 | | 364 |
| Cash and cash equivalents, end of period | | $ | 36,875 | $ | 7,040 |

See accompanying notes to the condensed consolidated interim financial statements

# STEP ENERGY SERVICES LTD.

## Notes to the condensed consolidated interim financial statements

(unaudited)

As at and for the three months ended March 31, 2020 and 2019.

Tabular amounts expressed in thousands of Canadian dollars, except where otherwise noted.

## NOTE 1 – NATURE OF BUSINESS AND BASIS OF PREPARATION

STEP Energy Services Ltd. (the "Company", "STEP Energy Services" or "STEP") is a publicly traded company domiciled in Canada, incorporated under the laws of the Province of Alberta on March 25, 2011 and is listed under the symbol "STEP" on the Toronto Stock Exchange. The registered office of the Company is 4300, 888 - 3rd Street SW, Calgary, Alberta T2P 5C5 and the principal place of business is 1200, 205-5th Ave SW, Calgary, Alberta T2P 2V7. STEP provides specialized coiled tubing and associated pumping and fracturing equipment to service the oil and gas industry in Canada and the United States ("U.S.").

### Statement of Compliance

These condensed consolidated interim financial statements are prepared in accordance with International Accounting Standard 34, Interim Financial Reporting. These condensed consolidated interim financial statements do not include all the information and disclosures required in the annual financial statements and should be read in conjunction with the Company's annual consolidated financial statements as at and for the year ended December 31, 2019.

These condensed consolidated interim financial statements were approved by the Board of Directors ("Board") on May 20, 2020.

### Seasonality of operations

The Company's Canadian business is seasonal in nature with the periods of greatest activity being in the first, third and fourth quarters, and the least activity tending to be in the second quarter because of spring break-up. Spring break-up typically occurs between March and June. The Company's operating activities can also be affected by extended periods of adverse weather which can result in restrictions to the movement of heavy equipment. Activity in the southern United States is generally not as influenced by seasonal conditions.

### Critical accounting estimates and judgments

The preparation of the condensed consolidated interim financial statements requires management to make certain estimates and judgments concerning the reported amount of revenue and expenses and the carrying values of assets and liabilities. These estimates are based on historical experience and management's judgment. The estimation of anticipated future events involves uncertainty and therefore the estimates used by management in the preparation of the condensed consolidated interim financial statements may change as events unfold, additional knowledge is acquired or the environment in which the Company operates changes.

*NOVEL Coronavirus - COVID 19*

During the three months ended March 31, 2020, the World Health Organization declared a global pandemic due to COVID-19. COVID-19 has resulted in extreme cautionary and containment measures on a global basis which has significantly impacted global demand for crude oil and natural gas. Additionally, the Organization of Petroleum Exporting Countries ("OPEC") and certain other countries implemented production capacity increases in an attempt to capture a greater share of global oil demand. The supply increases combined with COVID-19 demand decreases has resulted in substantial decreases in crude oil prices worldwide.

The combined impact of COVID-19 on the demand for oil and the OPEC+ supply pressures is materially reducing client spending and demand for STEP's services. Even as countries around the world are slowly re-opening businesses, international borders remain closed and concerns continue regarding increasing oil and natural gas storage levels.

In addition, COVID-19 has created many uncertainties with respect to counterparty credit risk, compliance with bank covenants in forecasted periods, liquidity and the valuation of long-lived assets, valuation of inventory and right-of-use assets. At March 31, 2020, management has incorporated the anticipated impact of COVID-19 in estimates and judgments in the preparation of these financial statements to the extent known at this time. Outcomes that are different from assumptions used in estimates could require a material adjustment within the next financial year.

### Changes in significant accounting policies

Except as described below, the same accounting policies and methods of computation were followed in preparation of these condensed consolidated interim financial statements as were followed in the preparation of the Company's annual consolidated financial statements for the year ended December 31, 2019.

*IFRS 3 – Business Combinations*
Amendments to IFRS 3 are effective as of January 1, 2020. The amendments narrow and clarify the definition of a business as an integrated set of activities and assets that are capable of being conducted and managed for the purpose of providing goods and services to customers, generating investment income or generating other income from ordinary activities. Additionally, in evaluating a business the amendments include an optional concentration test to permit a simplified assessment of whether an acquired set of activities and assets is not a business. STEP did not have any acquisitions requiring the application of this amendment.

## NOTE 2 – FUTURE OPERATIONS

### STEP's Future Operations

As at March 31, 2020, the Company was in compliance with all financial covenants on its bank credit facility. However, management's forecasts indicate a potential breach of its funded debt to adjusted bank EBITDA covenant and its adjusted bank EBITDA to interest coverage covenant within the next two quarters. Management forecasts may change materially as the impact of COVID-19 and OPEC+ supply pressures are better understood. A covenant violation would represent an event of default which would enable the lender to demand immediate repayment of all amounts due. As a result of these factors, there is a material uncertainty that may cast significant doubt with respect to the ability of the Company to continue as a going concern.

The Company intends to seek relief from the syndicate of lenders to the Company's credit facilities. The Company has commenced discussions with its banking syndicate leads. No agreement has been reached as of the date of the condensed consolidated interim financial statements and therefore, there can be no assurance that such agreement will be reached.

Management has assessed the expected impacts of a prolonged downturn on liquidity and will continue to refine its expectations as the effects of the recent global events are better understood. Management has taken actions to mitigate these impacts, which have included reductions in Board of Directors' remuneration, employee headcount reductions, wage reductions for all employees, reduced maintenance capital in alignment with reductions in active equipment, reduced leased facilities costs where possible and the disposal of some non-core assets. The Company's March 31, 2020 working capital has improved to $106.1 million from $72.2 million at December 31, 2019. Assuming the Company is successful in obtaining covenant relief for any potential forecasted covenant violations, Management's forecasts also show the Company meeting all of its financial commitments including interest payments over the next twelve months.

The condensed consolidated interim financial statements have been prepared on a going concern basis, which presumes the Company will continue its operations for the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the normal course of business. The condensed consolidated interim financial statements do not reflect adjustments and classifications of assets, liabilities, revenues and expenses, which would be necessary if the Company were unable to continue as a going concern. Such adjustments could be material.

## NOTE 3 – INVENTORY

| As at | | March 31, 2020 | | December 31, 2019 |
|---|---|---|---|---|
| Coiled tubing | $ | 4,866 | $ | 6,677 |
| Sand and chemicals | | 6,905 | | 8,217 |
| Spare equipment and parts | | 15,613 | | 13,508 |
| Total Inventory | $ | 27,384 | $ | 28,402 |

During the three months ended March 31, 2020, the Company incurred write-downs to net realizable value of $0.1 million (March 31, 2019 –$0.1 million) on certain coiled tubing strings.

## NOTE 4 – ASSETS HELD FOR SALE

In the prior year, the Company committed to the sale of a certain group of assets. The Company classified these assets as held for sale at December 31, 2019 and upon classification measured them at the lower of their carrying amount and estimated fair value less costs to sell. The process to divest these assets remains ongoing at March 31, 2020.

## NOTE 5 – PROPERTY AND EQUIPMENT

| | Land and buildings | Vehicles | Field equipment | Office equipment | Total |
|---|---|---|---|---|---|
| Cost: | | | | | |
| Balance at January 1, 2019 | $ 37,819 | $ 29,017 | $ 689,370 | $ 8,029 | $ 764,235 |
| Reclassification of opening right-of-use assets | - | (28,145) | - | - | (28,145) |
| Additions | 865 | - | 47,473 | 723 | 49,061 |
| Disposals | - | (199) | (5,053) | - | (5,252) |
| Reclassification of assets held for sale | (1,070) | - | (18,541) | (144) | (19,755) |
| Effect of exchange rate changes | (582) | (6) | (14,881) | (55) | (15,524) |
| Balance at December 31, 2019 | 37,032 | 667 | 698,368 | 8,553 | 744,620 |
| Additions | 141 | - | 11,513 | 40 | 11,694 |
| Disposals | - | - | (4,287) | - | (4,287) |
| Effect of exchange rate changes | 979 | 7 | 25,415 | 105 | 26,506 |
| **Balance at March 31, 2020** | **$ 38,152** | **$ 674** | **$ 731,009** | **$ 8,698** | **$ 778,533** |
| Accumulated depreciation: | | | | | |
| Balance at January 1, 2019 | $ 3,981 | $ 9,454 | $ 145,251 | $ 5,407 | $ 164,093 |
| Reclassification of opening right-of-use assets | - | (8,631) | - | - | (8,631) |
| Depreciation | 1,532 | 26 | 89,465 | 1,417 | 92,440 |
| Disposals | - | (186) | (1,765) | - | (1,951) |
| Reclassification of assets held for sale | (256) | - | (4,677) | (64) | (4,997) |
| Effect of exchange rate changes | (45) | (6) | (3,334) | 6 | (3,379) |
| Balance at December 31, 2019 | 5,212 | 657 | 224,940 | 6,766 | 237,575 |
| Depreciation | 397 | 4 | 23,925 | 262 | 24,588 |
| Impairment | 1,635 | - | 57,115 | - | 58,750 |
| Disposals | - | - | (2,484) | - | (2,484) |
| Effect of exchange rate changes | 95 | 7 | 7,066 | 37 | 7,205 |
| **Balance at March 31, 2020** | **$ 7,339** | **$ 668** | **$ 310,562** | **$ 7,065** | **$ 325,634** |
| Carrying amounts: | | | | | |
| As at December 31, 2019 | $ 31,820 | $ 10 | $ 473,428 | $ 1,787 | $ 507,045 |
| **As at March 31, 2020** | **$ 30,813** | **$ 6** | **$ 420,447** | **$ 1,633** | **$ 452,899** |

*(1) The Company reclassified prior year leased assets as right-of-use assets effective January 1, 2019 in accordance with the adoption of IFRS 16.*

Included in field equipment at March 31, 2020 were assets under construction of $2.1 million (December 31, 2019 - $9.9 million). Assets under construction are not depreciated until they are substantially complete and available for use.

During the three months ended March 31, 2020 the Company recognized an impairment expense of $58.8 million related to buildings and field equipment. See Note 6 for further discussion on the Company's impairment tests.

## NOTE 6 – IMPAIRMENT ASSESSMENT OF LONG-LIVED ASSETS

IAS 36 requires the Company to review the carrying values of its long-lived assets at each reporting period for indicators of impairment. STEP has identified four cash generating units ("CGUs"): Canadian Coiled Tubing, Canadian Fracturing, U.S. Coiled Tubing and U.S. Fracturing.

During the three months ended March 31, 2020, the Company identified indicators of impairment in all CGUs which included significant decreases in oil demand due to the COVID-19 outbreak, as well as geopolitical uncertainty regarding international cooperation on oil production cuts (see Note 1 – NOVEL Coronavirus – COVID 19 and Note 2 – Future Operations). Accordingly, impairment tests were conducted for all four CGUs.

The recoverable amounts of the CGUs were determined using the value in use method, based on multi-year discounted cash flows to be generated from continuing operations. Cash flow assumptions were based on a combination of expected future results, including management's best estimates of asset utilization, pricing for available equipment, costs to maintain that equipment and a post-tax discount rate of 15.4% (pre-tax 18.8%) for all CGUs. Discount rates were calculated using the Company's weighted-average cost of capital. A terminal growth rate of 2.0% was applied for cash flows beyond 2025.

A comparison of the recoverable amounts of each CGU with their respective carrying amounts resulted in an impairment charge in the Canadian Fracturing CGU against property and equipment of $58.8 million for the period ended March 31, 2020. The recoverable amount for the Canadian Fracturing CGU was determined to be $168.0 million. A post-tax discount rate of 12.7% would have caused the recoverable amount of the Canadian Fracturing CGU to be equal to its carrying value.

Assumptions that are valid at the time of preparing the impairment test may change significantly when new information becomes available. The Company will continue to monitor and update its assumptions and estimates with respect to impairment on an ongoing basis.

A 1% increase in the discount rate in the Canadian Fracturing CGU would have resulted in an additional impairment loss of $16.1 million. A 1% increase in the discount rate in the US Fracturing CGU would have resulted in an additional impairment loss of $5.6 million. Increasing the discount rate by 1% would not cause the carrying amount to exceed the recoverable amount for the Canadian Coiled Tubing or U.S. Coiled Tubing CGUs.

## NOTE 7 – LOANS AND BORROWINGS

At March 31, 2020, the Company has a borrowing agreement with a syndicate of financial institutions. The Company's agreement is comprised of operating facilities and a revolving facility (together the "Credit Facilities"). The Credit Facilities mature on June 25, 2022 and include a Canadian $313.3 million revolving credit facility, a Canadian $10.0 million operating facility and a U.S. $20.0 million operating facility. The maturity date of the Credit Facilities may be extended for an additional period of up to three years with syndicate approval. The Credit Facilities include a general security agreement providing a security interest over all present and after acquired personal property of the Company and all of its subsidiaries including mortgages on certain properties. An equity cure is available for the purposes of determining compliance with the Funded debt to Adjusted bank EBITDA ratio. The equity cure is available for use up to two times, in non-consecutive quarters. Each use of the equity cure is limited to $25.0 million from the issuance of equity securities and must be utilized to repay borrowings under the Credit Facilities. Under the Credit Facilities, any current and future leases that would have been accounted for as an operating lease at December 31, 2018 will continue to be recognized as operating leases for purposes of calculating financial covenants.

The Credit Facilities includes certain financial and non-financial covenants, including:

1) Funded debt to Adjusted bank EBITDA ratio refers to the ratio of total outstanding interest-bearing debt including lease obligations and letters of credit less cash and cash equivalents held with approved financial institutions to earnings before interest, share-based compensation, non-recurring gains and losses on the sale of property and equipment, unrealized foreign exchange gains and losses, taxes, depreciation, amortization, impairment, unrealized foreign exchange forward contract (gain) loss and transaction costs, non-cash impairment charges, other non-cash charges, discretionary management bonuses ("Adjusted bank EBITDA") of the Company for the twelve preceding months. Also, realized foreign exchange (gain) loss is excluded from Adjusted bank EBITDA. The Company amended its required funded debt to adjusted bank EBITDA ratios on January 22, 2020. The Company is required to meet the following funded debt to adjusted bank EBITDA ratios:

| Quarters Ended | Required Funded debt to Adjusted bank EBITDA ratio |
|---|---|
| March 31, 2020 to December 31, 2020 | 4.50:1 or less |
| March 31, 2021 and June 30, 2021 | 4.00:1 or less |
| September 30, 2021 and thereafter | 3.00:1 or less |

At March 31, 2020, the Funded debt to Adjusted bank EBITDA ratio was 3.33:1.00.

2) Interest coverage ratio refers to the ratio of Adjusted bank EBITDA to interest expense for the preceding twelve months. Interest expense includes interest charges, capitalized interest, interest on lease obligations, fees payable in respect of letters of credit and letters of guarantee, and discounts incurred and fees payable in respect of bankers' acceptance and LIBOR advances. Interest on lease obligations for current and future leases, which would have been accounted for as an operating lease at December 31, 2018 is not included in interest expense for purposes of calculating financial covenants. This ratio is not to fall below 3.00:1. At March 31, 2020, the Interest Coverage Ratio was 4.69:1.00.

The Company was in compliance with all financial covenants as at March 31, 2020. (see Note 2 – Future Operations)

Typical of facilities of this nature, the borrowing agreement contains a number of positive and negative covenants, which if breached, could result in an event of default. Given the unprecedented operating conditions currently being faced by the Company, continued compliance with these covenants is uncertain.

Interest is payable monthly, at the lead syndicate bank's prime lending rate plus 50 basis points to 300 basis points depending on certain financial ratios of the Company. The effective borrowing rate for loans and borrowings for the first quarter of 2020 was approximately 5.71%. At March 31, 2020, the full amount of the facility was available to be drawn on the Credit Facilities. The Company also had total outstanding letters of credit of $1.8 million. The total amount of credit facilities outstanding at March 31, 2020 is as follows:

| As at | | March 31, 2020 | | December 31, 2019 |
|---|---|---|---|---|
| Credit facilities | $ | 267,671 | $ | 239,819 |
| Deferred financing | | (3,163) | | (2,401) |
| Loans and borrowings | $ | 264,508 | $ | 237,418 |

The following table displays the movements in loans and borrowings during the three months ended March 31, 2020:

| | | |
|---|---|---|
| Balance at January 1, 2020 | $ | 237,418 |
| Issuance of loans and borrowings | | 24,627 |
| Deferred financing incurred | | (1,085) |
| Accretion of deferred financing charges | | 323 |
| Unrealized foreign exchange gain | | 2,598 |
| Foreign currency translation gain | | 627 |
| Balance at March 31, 2020 | $ | 264,508 |

## NOTE 8 – COMMITMENTS

The following table summarizes the Company's estimated commitments that are not included in the condensed consolidated interim statement of financial position related to leases as at March 31, 2020 for the following five years and thereafter:

| | 2020 | 2021 | 2022 | 2023 | 2024 | Thereafter | Total |
|---|---|---|---|---|---|---|---|
| Operating expenses for lease obligations(1) | $ 1,008 | $ 1,335 | $ 1,286 | $ 1,280 | $ 217 | $ 246 | $ 5,372 |
| Short term and low value lease obligations(1) | 78 | 14 | - | - | - | - | 92 |
| Total commitments | $ 1,086 | $ 1,349 | $ 1,286 | $ 1,280 | $ 217 | $ 246 | $ 5,464 |

*1) Includes U.S. obligations at an estimated forecast exchange rate of 1 USD = 1.40 CAD.*

Operating expenses related to lease obligations relate to leases of certain service centers and office space with lease terms of between 1 years and 6 years. The total expense recognized during the three months ended March 31, 2020 for short term and low value lease obligations was $0.4 million.

As at March 31, 2020, the Company has $1.2 million (December 31, 2019 - $0.9 million) of commitments related to capital expenditures. These commitments are expected to be incurred in fiscal 2020.

## NOTE 9 – SHARE CAPITAL

The Company is authorized to issue an unlimited number of common shares. The shares have no par value. All issued shares are fully paid.

| | Shares # | | Amount |
|---|---|---|---|
| Balance at January 1, 2019 | 66,682,319 | $ | 426,494 |
| Issued – exercise of share-based instruments | 260,511 | | 2,323 |
| Balance at December 31, 2019 | 66,942,830 | | 428,817 |
| Issued – exercise of share-based instruments | 25,199 | | 243 |
| Balance at March 31, 2020 | 66,968,029 | $ | 429,060 |

## NOTE 10 – SHARE-BASED COMPENSATION

### Equity settled share-based instruments

| | New stock options | Restricted share units | Performance share units | Prior stock options | Performance warrants | Total |
|---|---|---|---|---|---|---|
| Balance at January 1, 2019 | 201,987 | 770,574 | 505,316 | 3,749,728 | 8,160,788 | 13,388,393 |
| Granted | 1,971,489 | - | - | - | - | 1,971,489 |
| Cancelled via performance factor | - | - | (13,129) | - | - | (13,129) |
| Exercised | - | (237,648) | (23,018) | - | - | (260,666) |
| Forfeited/Expired | (51,716) | (137,955) | - | (217,219) | (660,660) | (1,067,550) |
| **Outstanding at December 31, 2019** | **2,121,760** | **394,971** | **469,169** | **3,532,509** | **7,500,128** | **14,018,537** |
| Exercisable at December 31, 2019 | 67,329 | - | - | 3,513,380 | 5,944,918 | 9,525,627 |

| | New stock options | Restricted share units | Performance share units | Prior stock options | Performance warrants | Total |
|---|---|---|---|---|---|---|
| Balance at January 1, 2020 | 2,121,760 | 394,971 | 469,169 | 3,532,509 | 7,500,128 | 14,018,537 |
| Granted | - | - | - | - | - | - |
| Cancelled via performance factor | - | - | (14,959) | - | - | (14,959) |
| Exercised | - | (16,163) | (9,036) | - | - | (25,199) |
| Forfeited/Expired | (153,682) | (57,179) | - | (22,000) | (117,730) | (350,591) |
| **Outstanding at March 31, 2020** | **1,968,078** | **321,629** | **445,174** | **3,510,509** | **7,382,398** | **13,627,788** |
| Exercisable at March 31, 2020 | 67,329 | - | - | 3,510,509 | 5,918,518 | 9,496,356 |

### Cash settled share-based instruments

| | Deferred share units | Cash-settled RSUs | Cash-settled PSUs | Total |
|---|---|---|---|---|
| Balance at January 1, 2019 | 137,634 | - | - | 137,634 |
| Granted | 424,005 | 2,527,497 | 847,379 | 3,798,881 |
| Exercised | (14,689) | - | - | (14,689) |
| Forfeited/Expired | - | (221,646) | - | (221,646) |
| **Outstanding at December 31, 2019** | **546,950** | **2,305,851** | **847,379** | **3,700,180** |
| Exercisable at December 31, 2019 | - | - | - | - |

| | Deferred share units | Cash-settled RSUs | Cash-settled PSUs | Total |
|---|---|---|---|---|
| Balance at January 1, 2020 | 546,950 | 2,305,851 | 847,379 | 3,700,180 |
| Granted | 135,632 | - | - | 135,632 |
| Exercised | - | - | - | - |
| Forfeited/Expired | - | (360,577) | - | (360,577) |
| **Outstanding at March 31, 2020** | **682,582** | **1,945,274** | **847,379** | **3,475,235** |
| Exercisable at March 31, 2020 | - | - | - | - |

The aggregate liability for all cash settled share-based instruments of $0.6 million is included in the statement of financial position in trade and other payables and other liabilities. At each reporting date, between grant date and settlement date of cash settled share-based instruments, the fair value of the liability is re-measured with any changes in fair value recognized in net loss for the period.

### Share-based compensation expense

The composition of share-based compensation expense incurred was:

| Three months ended March 31, | | 2020 | | 2019 |
|---|---|---|---|---|
| Prior stock options | $ | 4 | $ | (3) |
| New stock options | | 290 | | 89 |
| Performance warrants | | 36 | | (25) |
| Performance share units | | 290 | | 459 |
| Restricted share units | | 59 | | 660 |
| Cash-settled deferred share units | | (645) | | 83 |
| Cash-settled performance share units | | (96) | | - |
| Cash-settled restricted share units | | (878) | | - |
| Total share-based compensation expense | $ | (940) | $ | 1,263 |

## NOTE 11 – PER SHARE COMPUTATIONS

| Three months ended March 31, | 2020 | 2019 |
|---|---|---|
| Weighted average number of shares outstanding - basic | 66,943,938 | 66,683,211 |
| Dilutive impact of share-based compensation instruments | - | - |
| Weighted average number of shares outstanding - diluted | 66,943,938 | 66,683,211 |

For the three months ended March 31, 2020, 3.5 million prior stock options, 7.4 million performance warrants, 2.0 million new stock options, 0.3 million restricted share units, and 0.4 million performance share units were excluded from the diluted weighted average number of shares calculation as their effect would have been anti-dilutive (March 31, 2019: 3.6 million prior stock options, 7.7 million performance warrants, 0.2 million new stock options, 0.7 million restricted share units, and 0.5 million performance share units).

## NOTE 12 – PRESENTATION OF EXPENSES

| Three months ended March 31, | | 2020 | | 2019 |
|---|---|---|---|---|
| Operating expenses | | | | |
| Employee costs | $ | 53,610 | $ | 51,837 |
| Operating expense | | 42,141 | | 37,648 |
| Materials and inventory costs | | 65,946 | | 52,492 |
| | | 161,697 | | 141,977 |
| Depreciation | | 26,707 | | 24,719 |
| Share-based compensation | | (352) | | 643 |
| Total operating expenses | $ | 188,052 | $ | 167,339 |
| | | | | |
| Selling, general and administrative expenses | | | | |
| Employee costs | $ | 5,353 | $ | 5,955 |
| General expenses | | 2,017 | | 1,954 |
| | | 7,370 | | 7,909 |
| Allowance for doubtful accounts expense (recovery) | | 2,500 | | (34) |
| Depreciation | | 306 | | 348 |
| Share-based compensation | | (588) | | 620 |
| Total selling, general and administrative expenses | $ | 9,588 | $ | 8,843 |

## NOTE 13 – FINANCE COSTS

| Three months ended March 31, | | 2020 | | 2019 |
|---|---|---|---|---|
| Interest on loans and borrowings | $ | 3,808 | $ | 2,667 |
| Interest on lease obligations | | 271 | | 245 |
| Interest income | | 8 | | (14) |
| Accretion of deferred financing charges | | 323 | | 270 |
| Other | | 50 | | 85 |
| Total finance costs | $ | 4,460 | $ | 3,253 |

## NOTE 14 – FINANCIAL INSTRUMENTS

### Accounting classifications and fair values

Cash and cash equivalents, trade and other receivables, trade and other payables, and loans and borrowings are initially recognized at fair value and subsequently measured at amortized cost. The carrying value of cash and cash equivalents, trade and other receivables, and trade and other payables approximate their fair value due to the relatively short periods to maturity of the instruments. Loans and borrowings utilize floating rates and therefore fair market value approximates carrying value. The Company classifies its financial instruments measured at fair value according to the following hierarchy based on the amount of observable inputs used to value the instrument. Assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the placement within the fair value hierarchy.

- Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 - Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly; and
- Level 3 - Inputs that are not based on observable market data.

Foreign exchange forward contracts are classified and measured at fair value through profit or loss. Changes in fair value are recognized as they arise and are determined using quoted forward exchange rates at the reporting date (level 2). During the first quarter of 2020, there were no transfers between levels in the fair value hierarchy.

### Credit risk

Credit risk is the risk that a counterparty to a financial asset will not discharge its obligations, resulting in a financial loss to the Company. The majority of the Company's accounts receivable are with clients in the oil and natural gas industry and are subject to normal industry credit risks that include the ability to secure adequate debt or equity financing. During the three months ended March 31, 2020, global events have, and are expected to continue to have a significant impact on client credit risk (see Note 1 – NOVEL Coronavirus – COVID 19 and Note 2 – Future Operations). These factors have been incorporated in the Company's assessment of expected credit losses at March 31, 2020. The Company's clients are subject to an internal credit review, together with ongoing monitoring of the amount and age of balances in order to minimize the risk of non-payment. The Company has under taken additional procedures including but not limited to reviewing and updating all client credit limits, monitoring client payment patterns for deviations from normal course and applying liens where required.

The carrying amount of accounts receivable reflects the maximum credit exposure on this balance and management's assessment of the credit risk associated with its clients. The Company's objective is to minimize credit losses.

The Company's aged trade and other receivables are as follows:

| As at | | March 31, 2020 | | December 31, 2019 |
|---|---|---|---|---|
| Current (0 to 30 days from invoice date) | $ | 93,672 | $ | 63,698 |
| 31 - 60 days | | 34,038 | | 21,585 |
| 61 - 90 days | | 7,466 | | 12,442 |
| 91+ days | | 13,042 | | 9,297 |
| Receivables from trade clients | | 148,218 | | 107,022 |
| Other amounts | | 1,129 | | 1,334 |
| Allowance for doubtful accounts | | (5,956) | | (3,633) |
| Total trade and other receivables | $ | 143,391 | $ | 104,723 |

## Liquidity risk

Liquidity risk is the risk that the Company will be unable to fulfill its obligations on a timely basis or at a reasonable cost. The Company's objective in managing liquidity risk is to maintain sufficient available resources to meet its liquidity requirements at any point. The Company achieves this by managing its capital spending and maintaining sufficient funds for anticipated short-term spending in the cash and cash equivalents account. See Note 8 for commitments.

The expected timing of cash outflows relating to financial liabilities on the condensed consolidated interim statement of financial position as at March 31, 2020 are:

| | 2020 | 2021 | 2022 | 2023 | 2024 | Thereafter | Total |
|---|---|---|---|---|---|---|---|
| Lease obligations[(1)] | $ 8,463 | $ 6,937 | $ 3,050 | $ 1,964 | $ 1,201 | $ 428 | $ 22,043 |
| Trade and other payables | 107,507 | - | - | - | - | - | 107,507 |
| Income tax payable | 435 | - | - | - | - | - | 435 |
| Loans and borrowings[(2)] | 11,510 | 15,277 | 275,038 | - | - | - | 301,825 |
| | $ 127,915 | $ 22,214 | $ 278,088 | $ 1,964 | $ 1,201 | $ 428 | $ 431,810 |

1) *Includes interest portion of lease obligations.*
2) *Includes estimated interest and principle repayments, based on current amounts outstanding and current interest rates at March 31, 2020. Both are variable in nature.*

The Company anticipates that its cash on hand, trade accounts receivable and cash provided by operating activities, will be adequate to satisfy its liquidity requirements over the next twelve months. Total cash plus trade and other receivable exceeds the obligations in the table above as well as operating and capital commitments.

The Company has remaining capacity on its Credit Facilities of $81.7 million and has undertaken steps to reduce overall spend. Reductions in clients' cash flow or difficulty in their ability to source debt or equity also could negatively impact the Company's assessment of liquidity risk. See Note 1 – NOVEL Coronavirus – COVID 19 and Note 2 – Future Operations.

## Market risk

Market risk is the risk that the fair value of future cash flows of financial assets or liabilities will fluctuate due to movements in market rates. Market risk is comprised of interest rate risk, currency risk and other price risks which consist primarily of fluctuations in commodity prices.

## NOTE 15 - CONTINGENCIES AND PROVISIONS

### Litigation

Periodically, the Company may become involved in, named as a party to, or be the subject of various legal proceedings which are usually related to normal operational or labor issues. The results of such legal proceedings or related matters cannot be determined with certainty. The Company's assessment of the likely outcome of such matters is based on input from the internal examination of the facts of the case and advice from external legal advisors, which is based on their judgment of a number of factors including the applicable legal framework and precedents, relevant financial and operational information, and other evidence and facts specific to the matter as known at the time of the assessment.

In January 2017, Calfrac Well Services Ltd. ("Calfrac") filed a statement of claim in the Judicial District of Calgary in the Court of Queen's Bench against the Company and an employee of the Company seeking $10.0 million in damages among other relief. Calfrac alleges that the employee, who is a former employee of Calfrac, misappropriated certain competitively sensitive materials from Calfrac. Calfrac further alleges that STEP benefited or made use of such materials, resulting in damages to Calfrac. STEP is presently investigating the claim and at this time intends to contest allegations made in the claim. While management does not believe that this action will have a material adverse effect on the business or financial condition of the Company, no assurance can be given as to the final outcome of this or any other legal proceeding. If this claim, or any claims to which the Company may be subject in the future, were to be concluded in a manner adverse to the Company or if the Company elects to settle one or more of such claims, it could have a material adverse effect on its business, financial condition, results of operations and cash flows.

## NOTE 16 – OPERATING SEGMENTS

The Company's services are conducted by the Canadian Operations and the U.S. Operations segments. The results of each operating segment are summarized below. Transactions between the segments are recorded at fair value and have been eliminated upon consolidation.

### Segmented operating results and activity

| Three months ended March 31, 2020 | Canadian Operations | U.S. Operations | Corporate | Total |
|---|---|---|---|---|
| Revenue | | | | |
| Fracturing | $ 83,551 | $ 60,442 | $ - | $ 143,993 |
| Coiled tubing | 25,199 | 25,177 | - | 50,376 |
| Total revenue | 108,750 | 85,619 | - | 194,369 |
| Expenses | | | | |
| Operating expenses | 100,504 | 86,915 | 633 | 188,052 |
| Selling, general and administrative | 2,024 | 2,488 | 5,076 | 9,588 |
| Results from operating activities | 6,222 | (3,784) | (5,709) | (3,271) |
| Finance costs | - | - | 4,460 | 4,460 |
| Foreign exchange (gain) loss | 2,655 | (38) | - | 2,617 |
| (Gain) loss on disposal of property and equipment | (860) | 30 | - | (830) |
| Amortization of intangible assets | 10 | 118 | - | 128 |
| Impairment of property and equipment | 58,750 | - | - | 58,750 |
| Income (loss) before income tax | $ (54,333) | $ (3,894) | $ (10,169) | $ (68,396) |
| | | | | |
| Capital expenditures (1) | $ 5,112 | $ 9,908 | $ - | $ 15,020 |
| Total assets as at March 31, 2020 | $ 337,977 | $ 358,052 | $ 1,563 | $ 697,592 |
| Total liabilities as at March 31, 2020 | $ 324,407 | $ 80,925 | $ - | $ 405,332 |

| Three months ended March 31, 2019 | Canadian Operations | U.S. Operations | Corporate | Total |
|---|---|---|---|---|
| Revenue | | | | |
| Fracturing | $ 82,352 | $ 40,234 | $ - | $ 122,586 |
| Coiled tubing | 25,874 | 28,009 | - | 53,883 |
| Total revenue | 108,226 | 68,243 | - | 176,469 |
| Expenses | | | | |
| Operating expenses | 95,191 | 71,520 | 628 | 167,339 |
| Selling, general and administrative | 2,296 | 2,149 | 4,398 | 8,843 |
| Results from operating activities | 10,739 | (5,426) | (5,026) | 287 |
| Finance costs | - | - | 3,253 | 3,253 |
| Foreign exchange (gain) loss | (1,264) | (1) | - | (1,265) |
| (Gain) loss on disposal of property and equipment | (603) | (69) | - | (672) |
| Amortization of intangible assets | 9 | 1,765 | - | 1,774 |
| Loss on foreign exchange forward contracts | - | - | 383 | 383 |
| Income (loss)before income tax | $ 12,597 | $ (7,121) | $ (8,662) | $ (3,186) |
| | | | | |
| Capital expenditures (1) | $ 11,605 | $ 7,207 | $ - | $ 18,812 |
| Total assets as at December 31, 2019 | $ 371,496 | $ 312,184 | $ 2,359 | $ 686,039 |
| Total liabilities as at December 31, 2019 | $ 308,313 | $ 54,903 | $ - | $ 363,216 |

1) *Capital expenditures include non-cash expenditures from the addition of leased right-of-use assets.*

## NOTE 17 – SUBSEQUENT EVENT

On April 8, 2020 the U.S. Department of the Treasury and the Internal Revenue Service published final regulations addressing "anti-hybrid" rules under section 267A of the U.S. tax code. Pursuant to these regulations, the Company will no longer be entitled to certain tax benefits previously recognized during the period ended March 31, 2020 and for the year ended December 31, 2019. An increase to the deferred income tax liability in the amount of approximately $7.0 million will be recorded in the second quarter of 2020.

# CORPORATE INFORMATION

## Management

Regan Davis
President and Chief Executive Officer

Michael Kelly
Executive Vice-President and Chief Financial Officer

Steve Glanville
Vice-President, Operations and Chief Operating Officer

Rory Thompson
President, Canadian Operations

Brock Duhon
President, United States Operations

Lori McLeod-Hill
Vice-President, Finance

## Directors

Douglas Freel (1)

Evelyn Angelle (2)

Regan Davis (3)(4)

Jeremy Gackle (2)(5)

Donna Garbutt (6)(7)

James Harbilas (8)(9)

Jason Skehar (4)(9)

1. *Chair of the Board*
2. *Member of the Audit Committee*
3. *President and Chief Executive Officer*
4. *Member of the Health, Safety and Environment Committee*
5. *Chair of the Compensation and Corporate Governance Committee*
6. *Lead Director*
7. *Chair of the Health, Safety and Environment Committee*
8. *Chair of the Audit Committee*
9. *Member of the Compensation and Corporate Governance Committee*

## Corporate office

Bow Valley Square II
#1200, 205 – 5 Ave SW
Calgary, Alberta T2P 2V7

## Registered office

4300, 888 – 3rd Street SW
Calgary, Alberta T2P 5C5

## Website

www.stepenergyservices.com

## Trustee and transfer agent

TSX Trust Company
Calgary, Alberta and Toronto, Ontario

## Bank

ATB Corporate Financial Services

## Auditors

KPMG LLP
Chartered Professional Accountants
Calgary, Alberta

## Legal Counsel

Stikeman Elliott LLP

## Stock Symbol

"STEP"
Toronto Stock Exchange