# MANAGEMENT'S DISCUSSION AND ANALYSIS

*The following Management's Discussion and Analysis (MD&A) was prepared as of March 8, 2018 and is management's opinion about the consolidated operating and financial results of Freehold Royalties Ltd. and its wholly-owned subsidiaries (collectively, Freehold) for the year ended December 31, 2017 and previous periods, and the outlook for Freehold based on information available as of the date hereof.*

The financial information contained herein was based on information in the consolidated financial statements, which have been prepared in accordance with International Financial Reporting Standards (IFRS), which are the Canadian generally accepted accounting principles (GAAP) for publicly accountable enterprises. All comparative percentages are between the years ended December 31, 2017 and 2016, and all dollar amounts are expressed in Canadian currency, unless otherwise noted. This MD&A should be read in conjunction with the audited financial statements and notes.

This MD&A contains non-GAAP financial measures and forward-looking statements that are intended to help readers better understand our business and prospects. Readers are cautioned that the MD&A should be read in conjunction with our disclosure under "Non-GAAP Financial Measures" and "Forward-Looking Statements" included at the end of this MD&A.

### MD&A CONTENTS

# Business Overview

Freehold is a dividend-paying corporation incorporated under the laws of the Province of Alberta and trades on the Toronto Stock Exchange under the symbol FRU. We receive revenue from oil and natural gas properties as reserves are produced over the economic life of the properties. Our primary focus is acquiring and managing oil and natural gas royalties.

## The Royalty Advantage

We manage one of the largest non-government portfolios of oil and natural gas royalties in Canada. Our total royalty land holdings encompass approximately 5.7 million gross acres. Our mineral title lands (including royalty assumption lands), which we own in perpetuity, cover approximately 1.0 million acres and we have gross overriding royalty interests in approximately 4.7 million acres.

We have interests in more than 40,000 royalty wells. We receive royalty income from approximately 300 industry operators. Royalty rates vary from less than 1.0% (for some gross overriding royalties) to 22.5% (for some lessor royalties). This diversity lowers our risk, and as a royalty owner we benefit from the drilling activity of others on our lands.

As a royalty interest owner, we generally do not pay any of the capital costs to drill and equip the wells for production on most of our properties, nor do we incur costs to operate the wells, maintain production, and ultimately restore the land to its original state. Generally all of these costs are paid by others. On the majority of our production, we receive royalty income from gross production revenue (revenue before any royalty expenses and operating costs are deducted). Our high percentage of operating income from royalties (96% in 2017) results in strong netbacks.

When Freehold was formed in 1996, all of our royalty lands were leased to third parties and producing. Over the years, our unleased mineral title acreage has grown – through acquisitions, lease expiries, surrenders, and defaults. We now have approximately 430,000 acres of unleased mineral titles.

## Our Strategy

As a leading royalty company, Freehold's objective is to deliver growth and low risk attractive returns to shareholders over the long term. Freehold accomplishes this by:

- **Creating value**
    - Drive oil and gas development on our lands through our lease out programs.
    - Acquire royalty assets with acceptable risk profiles and long economic life.
    - Generate gross overriding royalties for revenue growth.
- **Enhancing value**
    - Maximize our royalty interests through a comprehensive audit program.
    - Manage our debt prudently with a target of 0.5-1.5 times net debt to funds from operations.
- **Delivering value**
    - Target a dividend with an adjusted payout ratio of 60%-80%.

# 2017 Highlights

2017 was another strong year for Freehold as we achieved a number of key financial and operational milestones. We continue to position Freehold as a low risk investment in oil and gas royalties.

### Annual Highlights

| ($000s, except as noted) | 2017 | 2016 | 2015 |
|---|---|---|---|
| Royalty and other revenue | 151,894 | 129,968 | 135,664 |
| Revenue, net of royalty expense | 150,720 | 128,651 | 133,367 |
| Net income (loss) | 12,218 | (11,163) | (4,080) |
| Per share, basic and diluted ($) | 0.10 | (0.10) | (0.05) |
| Funds from operations | 123,788 | 94,211 | 103,820 |
| Per share ($) | 1.05 | 0.85 | 1.15 |
| Total assets | 956,284 | 1,007,450 | 939,394 |
| Long-term debt | 90,000 | 84,000 | 152,000 |
| Total long-term liabilities | 106,025 | 108,637 | 179,826 |
| Dividends declared | 68,479 | 59,502 | 90,139 |
| Per share ($) (1) | 0.58 | 0.54 | 1.00 |
| Net debt | 68,621 | 73,161 | 146,949 |
| Weighted average shares outstanding, basic (000s) | 118,044 | 110,391 | 90,505 |
| Shares outstanding at year-end (000s) | 118,183 | 117,918 | 98,940 |
| Average daily production (boe/d) (2) | 12,350 | 12,219 | 10,945 |
| Operating netback ($/boe) (3) | 31.00 | 24.83 | 28.83 |

(1) Based on the number of shares issued and outstanding at each record date.

(2) See Conversion of Natural Gas to Barrels of Oil Equivalent (boe).

(3) See Non-GAAP Financial Measures.

- Achieved record production with volumes averaging 12,350 boe/d, representing a 1% increase over 2016, despite completing approximately 800 boe/d (based on 2016 production) in non-core working interest dispositions. Total production volumes were comprised of 55% oil and natural gas liquids (NGL) and 45% natural gas. Royalty volumes averaged 10,963 boe/d a 10% increase versus 2016, highlighting the improvement of our royalty portfolio.
- Funds from operations totaled $123.8 million or $1.05 per share, up from $94.2 million or $0.85 per share in 2016, reflecting gains in operations and strength in the commodity.
- Declared dividends totaled $68.5 million ($0.58 per share), up from $59.5 million ($0.54 per share) in 2016, reflecting increased funds from operations. Freehold increased its monthly dividend by 25% in April 2017.
- Exited 2017 with net debt of $68.6 million, implying net debt to funds from operations of 0.6 times. At year end we had $90 million of available room within our credit facility.
- Freehold completed $86.7 million in royalty acquisitions in 2017, adding new lands in the Cardium and further bolstering our key Viking royalty position.
- Proved plus probable reserves totaled 35.3 mmboe, down from 38.3 mmboe in 2016, with working interest dispositions in 2017 contributing to this reduction of reserves. A detailed review of Freehold's reserve information was provided as part of the annual information form (AIF). A copy of the AIF can be found on Freehold's website at www.freeholdroyalties.com or www.sedar.com.

# Outlook

## Business Environment

Macroeconomic drivers behind crude oil prices in 2017 centered on increased supply out of the United States offset by sustained strength in global demand and OPEC supply curtailments. Despite a challenged price environment, North American oil production has remained resilient as emerging plays such as the Permian and SCOOP Stack have delivered growth. Offsetting increased supply, global demand for crude oil has remained strong as emerging economies, including India and China, have remained reliant on crude oil to achieve economic growth. OPEC reaffirmed production quotas through the first half of 2018 which should aid in maintaining West Texas Intermediate (WTI) prices between US$50-$70/bbl.

WTI oil price rebounded in 2017 averaging US$50.95/bbl or 18% above the average price realized in 2016. Edmonton Light Sweet price maintained similar positive momentum in 2017 averaging $62.93/bbl, representing a 19% improvement versus 2016. Similarly, Western Canadian Select (WCS) price averaged $50.53/bbl, up 30% versus 2016. On the natural gas front, AECO prices averaged $2.43/mcf, up 16% year over year.

The Petroleum Services Association of Canada (PSAC) is currently projecting 7,900 wells drilled in 2018, up 5% versus the forecast for 2017. PSAC based its 2018 forecast on average natural gas prices of $2.50/mcf AECO and a WTI price of US$53.00/bbl and the Canadian dollar averaging $0.82/US$.

## Drilling Activity

Including drilling associated with acquisitions, 464 (22.3 net) wells were drilled on our royalty lands in 2017, a 65% increase versus 2016. The majority of the spending on our royalty lands continues to be focused on oil targets with approximately 60% of the drilling associated with prospects in southeast Saskatchewan and in the Viking formation. In addition, we have seen an uptick in activity associated with the Shaunavon in southwest Saskatchewan and liquids rich natural gas targets in the Deep Basin in Alberta. Based on these activity levels, we estimate $760 million was spent on our royalty lands in 2017. This compared to our estimate of $475 million in 2016. Looking into 2018, we remain optimistic that activity levels will remain strong on our royalty lands.

## Subsequent Events

Consistent with our strategy of enhancing our royalty focus, on February 14, 2018 Freehold disposed of our non-core working interest in the Pembina Cardium Unit No. 9 in Alberta for $8 million (before adjustments). As part of the transaction Freehold retained a 4% gross overriding royalty (GORR) on the same interests that were sold. Average production and operating income associated with the asset in 2017 was 179 boe/d and $2.1 million (before GORR), respectively. This deal reduced our decommissioning liability by approximately 40 net working interest wells and also reduced our exposure to capital activities as Freehold had $2.4 million of capital expenditures related to the property in 2017.

On February 28, 2018, Freehold completed a $7.0 million royalty acquisition in the prospective East Shale Duvernay Basin in central Alberta. As part of the transaction, Freehold acquired a 1.0% GORR on approximately 113,920 gross acres and a 3.0% GORR on 1,920 gross acres of royalty lands. The asset is has multiple years of development planned.

On March 7, 2018, Freehold closed two royalty acquisitions, one of them on the Weyburn Unit in Saskatchewan and the other on the Mitsue Gilwood Sand Unit #1 in Alberta. At Weyburn, where Freehold acquired a 0.2% lessor royalty, we see multi-year upside through expansion of the existing $CO_2$ enhanced oil recovery process and additional infill drilling. At Mitsue, where Freehold acquired a 1.9% new GORR interest, we see further value enhancing opportunities through waterflood optimization, reactivations and infill drilling. The purchase price associated with these transactions was $24 million (before adjustments) and the assignment by Freehold of certain minor working interest assets. Current production associated with the acquired royalty interests is approximately 110 boe/d (100% oil) and $2.6 million in annualized operating income assuming strip pricing. We see these transactions shallowing Freehold's already low corporate decline.

Both transactions were funded through Freehold's existing credit facilities.

## 2018 Guidance

The table below summarizes our key operating assumptions for 2018.

- We are assuming a production range of 11,750 boe/d to 12,250 boe/d. Volumes are expected to be weighted approximately 55% oil and natural gas liquids (NGL) and 45% natural gas. We continue to maintain our royalty focus with royalty production accounting for 93% of forecasted 2018 production and 99% of operating income.
- We are currently forecasting 25 net wells will be drilled on our lands in 2018, representing a 12% increase over near-record drilling on our lands in 2017.
- We are assuming WTI and WCS price assumptions of US$60.00/bbl and $45.00/bbl respectively, and AECO at $2.00/mcf.
- Our general and administrative expense assumption is forecast at $2.50/boe. Total cash costs are forecast to be approximately $5.00/boe.
- After increasing our monthly dividend by 5% from $0.05 to $0.0525 per share (see Change to Dividend), we expect our 2018 adjusted payout ratio ((cash dividends plus capital expenditures)/funds from operations) to be approximately 61%.
- We forecast year-end net debt to funds from operations of approximately 0.4 times based on our revised key operating assumptions.

**KEY OPERATING ASSUMPTIONS**

| 2018 Annual Average | | Guidance Dated Mar. 8, 2018 |
|---|---|---|
| Daily production | boe/d | 11,750-12,250 |
| West Texas Intermediate (WTI) crude oil | US$/bbl | 60.00 |
| Western Canadian Select (WCS) crude oil | Cdn$/bbl | 45.00 |
| AECO natural gas | Cdn$/Mcf | 2.00 |
| Exchange rate | Cdn$/US$ | 0.80 |
| Operating costs | $/boe | 1.45 |
| General and administrative costs [(1)] | $/boe | 2.50 |
| Weighted average shares outstanding | millions | 118 |

(1) Excludes share based compensation.

Recognizing the cyclical nature of the oil and gas industry, we continue to closely monitor commodity prices and industry trends for signs of changing market conditions. We caution that it is inherently difficult to predict activity levels on our royalty lands since we have no operational control. As well, significant changes (positive or negative) in commodity prices (including Canadian oil price differentials), foreign exchange rates, or production rates may result in adjustments to the dividend rate.

A sensitivity analysis of the potential impact of key variables on funds from operations per share is provided below. For the purposes of the sensitivity analysis, the effect of a change in a particular variable is calculated independently of any change in another variable. In reality, changes in one factor will contribute to changes in another, which can magnify or counteract the sensitivities. For instance, trends have shown a correlation between the movement in the foreign exchange rate of the Canadian dollar relative to the U.S. dollar and the benchmark WTI crude oil price.

| Variable [1] | Change (+/-) | Estimated Change in Funds from Operations ($/share) |
|---|---:|---:|
| West Texas Intermediate (WTI) crude oil | US$1.00/bbl | 0.03 |
| Canadian/U.S. dollar exchange rate | US$0.01 | 0.02 |
| WTI/WCS differential | US$1.00/bbl | 0.01 |
| AECO natural gas | Cdn$0.25/Mcf | 0.02 |
| Interest rate | 1% | 0.01 |
| Oil and NGL production | 100 bbls/d | 0.02 |
| Natural gas production | 1,000 Mcf/d | 0.005 |

(1) Calculations are performed independently and may not be indicative of actual results that would occur when multiple variables change at the same time.

## Change to Dividend

With increasing oil prices and strength in operations, Freehold's Board of Directors (the Board) has approved a 5% increase to its monthly dividend to $0.0525 per share or $0.63 per share annualized. The Board has declared a dividend of $0.0525 per common share to be paid on April 16, 2018 to shareholders of record on March 31, 2018. The dividend is designated as an eligible dividend for Canadian income tax purposes.

The dividend increase is in-line with our previously stated dividend policy which outlines a 60%-80% adjusted payout ratio based on forward looking funds from operations. Based on our current guidance and commodity price assumptions, and assuming no significant changes in the current business environment, we expect to maintain the revised monthly dividend rate. We will continue to evaluate the commodity price environment and adjust the dividend levels as necessary (subject to the quarterly review and approval of our Board – see Dividend Policy).

# Quarterly Performance

## Fourth Quarter Highlights

Freehold delivered strong operational results in the fourth quarter of 2017. Highlights included:

- Freehold's production averaged 12,032 boe/d, down 4% versus the same period in 2016. Reduced volumes were largely driven by non-core working interest dispositions (approximately 800 boe/d based on 2016) completed in 2017.
- Royalty production was up 6% compared to Q4-2016 averaging 10,960 boe/d. Increased volumes were largely associated with better than expected third party production additions and the strength in our audit function (over 600 boe/d of prior period adjustments in the quarter). Royalties, as a percentage of operating income (97%) and production (91%), highlight our commitment to our royalty focus.
- Q4-2017 royalty and other revenue was down 4% to $38.4 million versus the previous year largely due to reduced working interest production volumes.
- Net loss was $8.1 million compared to $1.6 million net income in Q4-2016. The loss was a result of a $16.2 million impairment charge on our working interest assets, approximately half from assets disposed of in Q4-2017 and subsequent to year end.
- Funds from operations for Q4-2017 totaled $32.0 million, an increase of 5% versus the same period in 2016. The increase year over year reflected growth in royalty revenue and lower cash costs. On a per share basis, funds from operations totaled $0.27 per share in Q4-2017, up from $0.26 per share in Q4-2016.
- Freehold closed the acquisition of a new 2% GORR in petroleum and natural gas rights in the Cardium, which included 166,000 gross acres of land in the greater Pembina area of Alberta. The purchase price of the GORR was $52 million plus the assignment by Freehold of certain minor working interest assets. The royalty assets are currently producing approximately 210 boe/d (74% light oil).
- Freehold generated $12.9 million in free cash flow [(1)], over and above our dividend in Q4-2017, which we applied to outstanding debt. At December 31, 2017, net debt totaled $68.6 million, up from $38.3 million at September 30, 2017, implying a net debt to 12-month trailing funds from operations ratio of 0.6 times. The increase in net debt quarter over quarter reflected the $52 million royalty acquisition which was funded through our existing credit facility.
- Cash costs [(1)] for the quarter totaled $5.13/boe, down from $7.83/boe in Q4-2016. The decrease versus Q4-2016 reflected lower operating expenses due to the continued disposition of our working interest portfolio and gains in royalty production.
- Wells drilled on our royalty lands totaled 112 (5.7 net) in the quarter, down from 144 (6.4 net) in the previous quarter.
- In Q4-2017, Freehold issued 32 leases associated with our unleased mineral title lands; 100 leases were issued in 2017, compared to 30 leases in all of 2016.
- Dividends declared for Q4-2017 totaled $0.15 per share, unchanged from the previous quarter and up from $0.12 per share one year ago.
- Basic payout ratio [(1)] (dividends declared/funds from operations) for Q4-2017 totaled 55% while the adjusted payout ratio [(1)] ((cash dividends plus capital expenditures)/funds from operations) for the same period was 60%.

(1) See Non-GAAP Financial Measures.

## 2017 Performance Compared to Guidance

**Compared to our November 2017 guidance:**

- Average production for the year was within our most recent guidance range and 1,350 boe/d better than our original guidance due to better than expected production additions on our royalty lands, volumes added through our audit function and acquisitions.
- Average oil prices, both for WTI and WCS were slightly ahead of our forecasts as prices improved through the fourth quarter.
- Operating costs were similar to the most recent forecast but lower than the original forecast as we continued to dispose of our non-core working interest assets.
- General and administrative charges were slightly lower than our most recent forecast and our original forecast reflecting increased royalty production.

**2017 Key Operating Assumptions**

| 2017 Annual Average | | 2017 Actual Results | Nov.9, 2017 | Nov. 8, 2016 |
|---|---|---|---|---|
| Daily production | boe/d | **12,350** | 12,000-12,500 | 11,000 |
| West Texas Intermediate crude oil | US$/bbl | **50.95** | 50.00 | 50.00 |
| Western Canadian Select crude oil | Cdn$/bbl | **50.53** | 49.00 | 46.00 |
| AECO natural gas | Cdn$/Mcf | **2.43** | 2.40 | 3.00 |
| Exchange rate | Cdn$/US$ | **0.77** | 0.77 | 0.75 |
| Operating costs | $/boe | **2.44** | 2.40 | 3.25 |
| General and administrative costs (1) | $/boe | **2.44** | 2.50 | 2.65 |
| Capital expenditures | $ millions | **5** | 4 | 6 |
| Weighted average shares outstanding | millions | **118** | 118 | 118 |

(1) Excludes share based compensation.

## Quarterly Performance and Seasonality

Quarterly variances in revenues, net income (loss) and funds from operations are caused mainly by fluctuations in commodity prices and production volumes. Crude oil prices are generally determined by global supply and demand factors, and the variances do not have seasonal predictability. Natural gas is a typically seasonal, weather-dependent fuel; demand is generally higher during the winter (for heating) and summer (for cooling), and lower during the spring and fall. Over most of the past eight quarters, this seasonality has been muted by ample supply.

Our financial results over the last eight quarters were influenced by the following significant changes:

- Oil prices continue to be largely affected by OPEC decisions on production cuts and U.S. production growth, with further affects in western Canada from transportation constraints.
- Fluctuations in the U.S./Canadian exchange rate also affects our oil price realizations, resulting in positive or negative impacts on our Canadian dollar oil revenues relative to the benchmark WTI, which is referenced in U.S. dollars. The increasing value of the Canadian dollar in recent quarters had a negative effect on our oil price realizations.
- AECO natural gas prices continue to be negatively impacted by supply outstripping demand, especially in western Canada where there are added transportation constraints.
- The largest effect on our dividends is from funds from operations, which is mainly a function of revenues and cash expenses; however the timing of dividend adjustments is dependent on forward projections and the decisions of our Board. Improvement in oil prices led to the dividend increase in 2017.

- Production has been affected by drilling activity, acquisitions and dispositions, as well as prior period adjustments. We use government reporting databases and past production receipts to estimate revenue accruals. Due to the large number of wells in which we have royalty interests, the nature of royalty interests, the lag in receiving production receipts, and our audit program, our reported royalty volumes usually include both positive and negative adjustments related to prior periods.
- Over the past eight quarters, we have acquired $249.3 million of royalty assets in Alberta and Saskatchewan. Freehold also disposed of $32.4 million of our working interest properties in 2017. This activity affects our revenues, operating costs, percentage royalty interests, oil, NGL and natural gas production mix, debt levels and shares outstanding, among others.
- Net income (loss) may be affected by large unique items in any given period. Freehold had a $1.1 million loss on settlement of certain legal proceedings in Q3-2016, a $5.6 million impairment reversal in Q1-2017, a $14.7 million gain on working interest dispositions in Q2-2017 and a $16.2 million impairment in Q4-2017.

The accompanying table illustrates the fluctuations experienced over the past eight quarters and the resulting effect on our financial results. Additional information about our quarterly results is provided in our interim reports, copies of which are available on SEDAR and on our website.

## QUARTERLY REVIEW

| | 2017 | | | | 2016 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 |
| **Financial** ($000s, except as noted) | | | | | | | | |
| Revenue, net of royalty expense | 38,235 | 33,763 | 38,036 | 40,686 | 39,439 | 32,639 | 31,903 | 24,670 |
| Funds from operations | 32,023 | 27,927 | 31,769 | 32,069 | 30,421 | 24,148 | 24,142 | 15,500 |
| Per share, basic ($) | 0.27 | 0.24 | 0.27 | 0.27 | 0.26 | 0.21 | 0.23 | 0.16 |
| Net income (loss) | (8,057) | 103 | 13,084 | 7,088 | 1,638 | (1,962) | (2,249) | (8,590) |
| Per share, basic and diluted ($) | (0.07) | - | 0.11 | 0.06 | 0.01 | (0.02) | (0.02) | (0.09) |
| Dividends declared | 17,722 | 17,714 | 17,705 | 15,338 | 14,144 | 14,133 | 13,380 | 17,845 |
| Per share ($) (1) | 0.15 | 0.15 | 0.15 | 0.13 | 0.12 | 0.12 | 0.12 | 0.18 |
| Basic payout ratio (%) (2) | 55 | 63 | 56 | 48 | 46 | 59 | 55 | 115 |
| Operating Income (2) | 36,149 | 31,246 | 35,235 | 37,084 | 34,487 | 28,231 | 28,011 | 20,292 |
| Operating income from royalties (%) | 97 | 99 | 97 | 91 | 93 | 93 | 91 | 97 |
| Dividends paid in shares (DRIP) (3) | - | - | - | - | - | 1,170 | 1,443 | 2,384 |
| Average DRIP participation rate (%) (3) | - | - | - | - | - | 8 | 11 | 11 |
| Acquisitions | 52,270 | (146) | 1,267 | 33,352 | 92 | 68 | 162,211 | 219 |
| Capital expenditures | 1,356 | 1,657 | 1,139 | 712 | 2,172 | 209 | 753 | 2,084 |
| Working interest dispositions | 354 | 2,969 | 28,808 | 288 | - | - | - | - |
| Net debt | 68,621 | 38,274 | 49,819 | 76,030 | 73,161 | 87,301 | 98,191 | 149,197 |
| **Shares outstanding** | | | | | | | | |
| Weighted average, basic (000s) | 118,128 | 118,073 | 118,018 | 117,956 | 117,847 | 117,726 | 106,736 | 99,093 |
| At quarter end (000s) | 118,183 | 118,128 | 118,073 | 118,018 | 117,918 | 117,850 | 117,652 | 99,284 |
| **Operating** ($/boe, except as noted) | | | | | | | | |
| Average daily production (boe/d) (4) | 12,032 | 12,036 | 12,589 | 12,753 | 12,579 | 12,281 | 12,041 | 11,974 |
| Royalty interest (%) | 91 | 91 | 90 | 84 | 82 | 83 | 81 | 79 |
| Average selling price | 33.59 | 29.67 | 32.98 | 34.88 | 33.72 | 28.69 | 28.48 | 22.23 |
| Operating netback (2) | 32.66 | 28.22 | 30.76 | 32.31 | 29.80 | 24.99 | 25.57 | 18.62 |
| Operating expenses | 1.88 | 2.27 | 2.45 | 3.14 | 4.28 | 3.90 | 3.55 | 4.02 |
| Working interest properties | 21.16 | 24.49 | 23.34 | 19.51 | 24.16 | 22.69 | 18.47 | 19.41 |
| General and administrative expenses (5) | 2.59 | 1.88 | 2.27 | 3.01 | 2.33 | 1.71 | 2.04 | 3.05 |
| **Benchmark Prices** | | | | | | | | |
| West Texas Intermediate crude oil (US$/bbl) | 55.40 | 48.21 | 48.29 | 51.91 | 49.29 | 44.94 | 45.59 | 33.45 |
| Exchange rate (Cdn$/US$) | 0.79 | 0.80 | 0.74 | 0.76 | 0.75 | 0.77 | 0.78 | 0.73 |
| Edmonton Light Sweet crude oil (Cdn$/bbl) | 69.14 | 56.73 | 61.84 | 64.00 | 61.54 | 54.85 | 54.70 | 40.84 |
| Western Canadian Select crude oil (Cdn$/bbl) | 54.87 | 47.89 | 49.99 | 49.38 | 46.63 | 41.02 | 41.62 | 26.32 |
| AECO natural gas (Cdn$/Mcf) | 1.96 | 2.04 | 2.77 | 2.94 | 2.81 | 2.20 | 1.25 | 2.11 |
| **Share Trading Performance** | | | | | | | | |
| High ($) | 16.41 | 15.15 | 14.37 | 14.75 | 15.16 | 13.09 | 13.00 | 12.05 |
| Low ($) | 13.77 | 12.51 | 11.96 | 12.22 | 11.68 | 10.61 | 9.66 | 8.29 |
| Close ($) | 14.05 | 14.74 | 13.05 | 13.48 | 14.17 | 12.65 | 11.91 | 10.54 |
| Volume (000s) | 13,985 | 13,428 | 13,890 | 17,059 | 15,440 | 20,873 | 23,559 | 19,690 |

(1) Based on the number of shares issued and outstanding at each record date.
(2) See Non-GAAP Financial Measures.
(3) The dividend reinvestment plan (DRIP) was suspended effective with the August 2016 dividend, pending further notice.
(4) Reported production for a period may include adjustments from previous production periods.
(5) Excludes share based compensation.

# Revenues

## Production

As we hold royalty interests in over 40,000 wells, obtaining timely production data is extremely difficult. Thus, we use government reporting databases and past production receipts to estimate revenue accruals. Due to the large number of wells in which we have royalty interests, the nature of royalty interests, the lag in receiving production receipts, and our audit program, our reported royalty volumes usually include both positive and negative adjustments related to prior periods.

Our production was up 1% in 2017 primarily associated with volumes added through acquisitions, production additions on our royalty lands and the strength of our audit function, offset by non-core working interest dispositions. As a result of this activity, royalty interests comprised 89% of total production in 2017, up from 81% in 2016. Our production mix for 2017 was 45% natural gas, 14% heavy oil, 33% light and medium oil, and 8% NGLs. Natural gas and NGL production increases are largely a function of the drilling activity on some of our lands in the Deep Basin in addition to our 2016 acquisitions.

Working interest production declined 39% in 2017 versus 2016. Reduced volumes largely resulted from 2017 dispositions and continued low development expenditures. Production from the disposition properties totaled approximately 800 boe/d in 2016 compared to approximately 200 boe/d in 2017 results.

### Production Summary (1)

| (boe/d) | 2017 | 2016 | Change |
|---|---|---|---|
| Royalty interest | 10,963 | 9,936 | 10% |
| Working interest | 1,387 | 2,283 | -39% |
| Total | 12,350 | 12,219 | 1% |

(1) On certain properties where we have both a royalty interest and a working interest, production is allocated based on the applicable royalty and working interest percentages.

### Average Daily Production by Product Type

| | 2017 | 2016 | Change |
|---|---|---|---|
| Light and medium oil (bbls/d) | 4,058 | 4,293 | -5% |
| Heavy oil (bbls/d) | 1,695 | 2,016 | -16% |
| NGL (bbls/d) | 1,039 | 804 | 29% |
| Total oil and NGL (bbls/d) | 6,792 | 7,113 | -5% |
| Natural gas (Mcf/d) | 33,346 | 30,632 | 9% |
| Oil equivalent (boe/d) | 12,350 | 12,219 | 1% |
| Total annual production (Mboe) | 4,507 | 4,472 | 1% |
| Potash (tonnes/d) | 10 | 12 | -17% |

## Product Prices

West Texas Intermediate oil price rebounded in 2017 as a result of better supply/demand fundamentals, averaging US$50.95/bbl or 18% above the average price realized in 2016. Edmonton Light Sweet price maintained similar positive momentum in 2017 averaging $62.93/bbl, representing a 19% improvement versus 2016. Similarly, Western Canadian Select price averaged $50.53/bbl, up 30% versus 2016. On the natural gas front, AECO prices averaged $2.43/mcf, up 16% versus last year.

### Average Benchmark Prices

| | 2017 | 2016 | Change |
|---|---|---|---|
| West Texas Intermediate (WTI) crude oil (US$/bbl) | 50.95 | 43.32 | 18% |
| Exchange rate (Cdn$/US$) | 0.77 | 0.76 | 1% |
| Edmonton Light Sweet (EDM) crude oil (Cdn$/bbl) | 62.93 | 52.98 | 19% |
| Western Canadian Select (WCS) crude oil (Cdn$/bbl) | 50.53 | 38.90 | 30% |
| WTI/WCS differential (US$/bbl) | (11.98) | (13.84) | -13% |
| AECO natural gas (Cdn$/Mcf) | 2.43 | 2.09 | 16% |

The price we receive for our oil production is primarily driven by the U.S. dollar price of WTI. It is also affected by the US$/Cdn$ exchange rate, with an increase in the value of the Canadian dollar relative to the U.S. dollar decreasing the revenue received, which occurred in 2017 with a 1% increase in the exchange rate relative to 2016. Our average realized oil prices also reflect product quality and transportation differences from benchmark prices. Our natural gas price realizations are discounted compared to AECO pricing as they include transportation and processing fees netted from some natural gas royalty payments. On a boe basis, our average selling price was 16% higher in 2017 reflecting increased prices for oil.

### Average Realized Prices

| | 2017 | 2016 | Change |
|---|---|---|---|
| Oil ($/bbl) | 53.14 | 42.38 | 25% |
| NGL ($/bbl) | 36.86 | 29.58 | 25% |
| Oil and NGL ($/bbl) | 50.65 | 40.93 | 24% |
| Natural gas ($/Mcf) | 1.83 | 1.81 | 1% |
| Oil equivalent ($/boe) | 32.80 | 28.37 | 16% |

## Marketing and Hedging

Our production remained unhedged in 2017. Our hedging policy is reviewed quarterly with the Board.

Our royalty lands consist of a large number of properties with generally small volumes per property. Many of our leases and royalty agreements allow us to take our share of oil and natural gas in-kind. As part of our risk mitigation program we carefully monitor our royalty receivables and may choose to take our royalty in-kind if there are benefits in doing so. Currently we take in-kind and market approximately 18% of our total royalty production using 30-day contracts.

## Royalty and Other Revenue

Royalty and other revenue in 2017 was 17% higher than in 2016 largely due to improved realized oil pricing and slightly higher production. Offsetting higher royalty revenues, working interest revenues were down 32% versus 2016, as a result of $32.4 million of dispositions and continued low capital expenditures on development.

### Royalty and Other Revenue

| ($000s) | 2017 | 2016 | Change |
|---|---|---|---|
| Royalty interest revenue (1) | 133,822 | 103,464 | 29% |
| Working interest revenue (2) | 18,072 | 26,504 | -32% |
| Total royalty and other revenue | 151,894 | 129,968 | 17% |

(1) Royalty interest revenue includes potash, sulphur, bonus consideration and lease rentals.
(2) Working interest revenue includes processing fees, interest and other.

### Royalty and Other Revenue by Product

| ($000s) | 2017 | 2016 | Change |
|---|---|---|---|
| Oil | 111,569 | 97,859 | 14% |
| NGL | 13,975 | 8,709 | 60% |
| Natural gas | 22,294 | 20,304 | 10% |
| Other (1) | 4,056 | 3,096 | 31% |
| Total royalty and other revenue | 151,894 | 129,968 | 17% |

(1) Other includes potash, sulphur, bonus consideration, lease rentals, processing fees, interest and other.

The following table demonstrates the net effect of price and volume variances on royalty and other revenue. Strength in oil prices accounted for the positive variance in 2017. There were also positive effects from gas production increases and negative effects from oil production decreases.

### Royalty and Other Revenue Variances

| ($000s) | 2017 vs. 2016 | 2016 vs. 2015 |
|---|---|---|
| **Oil and NGL** | | |
| Production increase (decrease) | (6,326) | 5,618 |
| Price increase (decrease) | 25,302 | (10,763) |
| Net increase (decrease) | 18,976 | (5,145) |
| **Natural gas** | | |
| Production increase | 1,757 | 3,694 |
| Price increase (decrease) | 233 | (4,307) |
| Net increase (decrease) | 1,990 | (613) |
| **Other** [(1)] | 960 | 62 |
| Gross revenue increase (decrease) | 21,926 | (5,696) |

(1) Other includes potash, sulphur, bonus consideration, lease rentals, processing fees, interest and other.

# Expenses

## Royalty Expense and Mineral Taxes

Oil and gas producers pay royalties to the owners of mineral rights from whom they have acquired leases. These are paid to the Crown (provincial and federal governments) and freehold mineral title owners. Crown royalty rates are tied to commodity prices and the level of oil and gas sales.

We do not incur royalty expense on production from our royalty interest lands, other than minor freehold mineral taxes. As the royalty owner, we receive the royalty as income from other companies. Royalty expense decreased by 11% in 2017 due to reduced working interest revenue and production.

### Royalty Expense [(1)]

| ($000s, except as noted) | 2017 | 2016 | Change |
|---|---|---|---|
| **Working interest** | 1,059 | 1,226 | -14% |
| Per boe ($) | 2.09 | 1.47 | 42% |
| **Royalty interest** | 115 | 91 | 26% |
| Per boe ($) | 0.03 | 0.03 | 0% |
| **Total** | 1,174 | 1,317 | -11% |
| Per boe ($) | 0.26 | 0.29 | -10% |

(1) Royalty expense includes both Crown charges and royalty payments to third parties.

## Operating Expenses

Operating expenses are comprised of direct costs incurred and costs allocated to oil, natural gas, and NGL production activities. Overhead recoveries associated with operated properties are included in operating expenses and accounted for as a reduction to general and administrative expenses. A percentage of operating expense is fixed and, as such, per boe operating expenses are highly variable to production volumes.

On a total production per boe basis, operating expense decreased 38% in 2017, largely due an increase in our percentage of production from royalties, which have no operating expenses. Working interest operating expenses increased by 3% on a per boe basis largely as a result of the effect of fixed costs on decreasing production. On an absolute measure, operating costs were down 38% versus the same period in 2016 reflecting dispositions of our working interest assets and increasing royalty production.

### Operating Expenses

| ($000s, except as noted) | 2017 | 2016 | Change |
|---|---|---|---|
| **Working interest** | **11,006** | 17,630 | -38% |
| Per boe ($) | **21.75** | 21.10 | 3% |
| **Royalty interest** [1] | - | - | - |
| Per boe ($) | - | - | - |
| **Total operating expenses** | **11,006** | 17,630 | -38% |
| Per boe ($) | **2.44** | 3.94 | -38% |

(1) We do not incur operating expenses on production from our royalty lands.

## Netback Analysis

As a royalty owner, we share in production revenue without incurring the operational costs, risks, and responsibilities typically associated with oil and natural gas operations. The following tables demonstrate the advantage of our royalty lands, which have no operating or royalty expenses other than minor freehold mineral taxes. Royalty interests accounted for 88% of royalty and other revenue in 2017 and more importantly contributed 96% of operating income.

### 2017 Operating Income [1]

| ($000s) | Royalty Interest | Working Interest | Total |
|---|---|---|---|
| Royalty and other revenue [2] | 133,822 | 18,072 | **151,894** |
| Royalty expense [3] | (115) | (1,059) | **(1,174)** |
| Net revenue | 133,707 | 17,013 | **150,720** |
| Operating expense | - | (11,006) | **(11,006)** |
| Operating income | 133,707 | 6,007 | **139,714** |
| Percentage by category | 96% | 4% | **100%** |

(1) See Non-GAAP Financial Measures.
(2) Royalty interest revenue includes potash, sulphur, bonus consideration and lease rentals. Working interest revenue includes processing fees, interest, and other.
(3) Royalty expense includes both Crown charges and royalty payments to third parties.

### 2017 Operating Netback [1]

| ($ per boe) | Royalty Interest | Working Interest | Total |
|---|---|---|---|
| Royalty and other revenue | 33.44 | 35.72 | **33.70** |
| Royalty expense [2] | (0.03) | (2.09) | **(0.26)** |
| Net revenue | 33.41 | 33.63 | **33.44** |
| Operating expense | - | (21.75) | **(2.44)** |
| Operating netback | 33.41 | 11.88 | **31.00** |

(1) See Non-GAAP Financial Measures.
(2) Royalty expense includes both Crown charges and royalty payments to third parties.

### 2017 vs. 2016 Operating Netback [1]

| ($ per boe) | 2017 | 2016 | Change |
|---|---|---|---|
| Royalty interest | **33.41** | 28.42 | 18% |
| Working interest | **11.88** | 9.15 | 30% |
| Total | **31.00** | 24.83 | 25% |

(1) See Non-GAAP Financial Measures.

## General and Administrative Expenses

We have significant land administration, accounting and auditing requirements to administer and collect royalty payments, including systems to track development activity on the royalty lands. General and administrative (G&A) expenses include direct costs and reimbursement of G&A expenses incurred by Rife Resources Management Ltd. (the Manager) on behalf of Freehold (see Related Party Transactions).

In 2017, on a total dollar basis, G&A expenses were up 8% associated with our acquisition and disposition activity. On a per boe basis costs were up 7% year over year offset slightly by increased production volumes.

### General and Administrative Expenses

| ($000s, except as noted) | 2017 | 2016 | Change |
|---|---|---|---|
| General and administrative expenses, | | | |
| before capitalized and overhead recoveries | 12,608 | 11,772 | 7% |
| Less: capitalized and overhead recoveries | (1,593) | (1,588) | 0% |
| General and administrative expenses | 11,015 | 10,184 | 8% |
| Per boe ($) | 2.44 | 2.28 | 7% |

## Management Fees

The Manager (see Related Party Transactions) receives a management fee in Freehold common shares. The amended and restated management agreement dated November 9, 2015 (the Management Agreement) capped the management fee at 71,912 Freehold common shares per quarter for 2016 and 55,000 Freehold common shares per quarter for 2017, with the fee decreasing to 5,500 shares by 2023. The value associated with the management fee was down 14% compared to 2016 reflecting the reduction in shares, offset somewhat by a higher Freehold common share price in 2017. The quarterly management fee for 2018 will be 55,000 Freehold common shares per quarter.

### Management Fees (paid in shares)

| | 2017 | 2016 | Change |
|---|---|---|---|
| Shares issued in payment of management fees | 220,000 | 287,648 | -24% |
| Ascribed value ($000s) (1) | 3,043 | 3,543 | -14% |
| Per boe ($) | 0.68 | 0.79 | -14% |

(1) The ascribed value of the management fees is based on the closing share price at the end of each quarter.

## Share Based Compensation

**LONG-TERM INCENTIVE PLANS**

In March 2017, Freehold adopted a new long-term incentive plan (LTIP) to replace the previous long-term incentive plan for the employees of Rife Resources Ltd. (see Related Party Transactions). Grants will no longer be made under the previous plan but pre-existing grants will continue until vesting and payout occurs. In 2017 and in future years, Freehold's long-term incentive compensation will consist of grants of performance share units (PSUs) and restricted share units (RSUs) under the new LTIP. Under both the new and previous LTIP, compensation expense is based on Freehold share price, the number of share based awards outstanding at each period end, an estimated performance multiplier, if applicable, and an estimated forfeiture rate. Compensation expense is recognized over the vesting period.

The 2014 grants under the previous LTIP valued at $0.1 million vested and were paid out in 2017 (2013 grants vested in 2016 and $0.1 million was paid out). In 2017 there was $1.2 million of expense for the LTIPs (2016 - $0.8 million).

**DEFERRED SHARE UNIT PLAN**

Pursuant to our deferred share unit plan, fully-vested deferred share units (DSUs) are granted annually in the first quarter to non-management directors and are redeemable for an equal number of Freehold common shares (less tax withholdings if necessary) after the director's retirement. Dividends declared prior to redemption are assumed to be reinvested in notional share units on the dividend payment date. In 2017 Freehold expensed $0.4 million (2016 - $0.4 million) of share based compensations with a corresponding offset to contributed surplus.

On January 1, 2017 the Board granted 27,521 DSUs to eligible directors and 34,519 DSUs were granted on January 1, 2018. During 2017 a retired director redeemed 63,419 DSUs, resulting in the issuance of 44,393 Freehold common shares from treasury and the cancellation of 19,026 DSUs for withholding tax (2016 – 84,567 DSUs redeemed with 59,198 Freehold common shares issued from treasury and 25,369 cancelled for withholding tax).

As at December 31, 2017, there were 117,429 DSUs outstanding, and at March 8, 2017, there were 152,952 DSUs outstanding (including notional DSUs granted as a result of dividends paid on our common shares).

### Share Based Compensation

| ($000s, except as noted) | 2017 | 2016 | Change |
|---|---|---|---|
| Gross LTIP | 1,446 | 928 | 56% |
| Less: capitalized portion | (246) | (167) | 47% |
| Net LTIP | 1,200 | 761 | 58% |
| Deferred share unit plan | 391 | 442 | -12% |
| Retirement benefit | - | 5 | -100% |
| Share based and other compensation | 1,591 | 1,208 | 32% |
| Per boe ($) | 0.35 | 0.27 | 30% |

## Related Party Transactions

Freehold does not have any employees. Rife Resources Management Ltd. (the Manager) is the manager of Freehold. The Manager is a wholly-owned subsidiary of Rife Resources Ltd. (Rife), and two of Rife's directors are also directors of Freehold. Rife is 100% owned by the CN Pension Trust Funds (the pension funds for the employees of the Canadian National Railway Company), which in turn is a shareholder of Freehold. The Manager recovers its general and administrative costs and a portion of its long-term incentive plan costs, and receives a quarterly management fee paid in shares. Canpar Holdings Ltd. (Canpar) is also managed by Rife and owned 100% by the CN Pension Trust Funds, and two of Canpar's directors are also directors of Freehold.

**(a) Rife Resources Management Ltd.**

The Manager provides certain services for a fee based on a specified number of shares per quarter, pursuant to the amended and restated Management Agreement. The Management Agreement capped the management fee at 55,000 shares per quarter for 2017 and the number of shares to be issued per quarter as payment of the management fee decreases to a level of 5,500 shares per quarter by 2023. For the year ended December 31, 2017, Freehold issued 220,000 shares (2016 – 287,648) as payment of the management fee to the Manager pursuant to the Management Agreement. For the year ended December 31, 2017, the ascribed value of $3.0 million (2016 – $3.5 million) was based on the closing price of the shares on the last trading day of each quarter.

For the year ended December 31, 2017, the Manager charged $9.5 million in general and administrative costs (2016 – $9.0 million). At December 31, 2017, there was $0.6 million (2016 – $0.9 million) in accounts payable and accrued liabilities relating to these costs.

**(b) Rife Resources Ltd.**

Freehold maintains ownership interests in certain oil and gas properties operated by Rife. A portion of net operating revenues and capital expenditures represent joint operations amounts from Rife. At December 31, 2017, there was $nil (2016 - $0.1 million) in accounts receivable related to these transactions. At December 31, 2017, there was $0.1 million (2016 - $nil) in accounts payable and accrued liabilities relating to these transactions.

In addition, Freehold receives royalties from Rife pursuant to various royalty agreements. For the year ended December 31, 2017, Freehold received royalties of approximately $0.9 million (2016 – $0.9 million). At December 31, 2017, there was $0.1 million (2016 - $0.1 million) in accounts receivable relating to these transactions.

**(c) Canpar Holdings Ltd.**

Freehold and Canpar share mineral title ownership rights in a substantial land base in western Canada. Generally, Canpar owns mineral rights that were below the deepest producing formation at the time that Freehold was created, and Freehold holds the balance of the mineral rights. Given the nature of the mineral rights, which are dependent upon hydrocarbon pool formation classification as well as third party drilling data which is subject to change and revision, significant uncertainty can exist with respect to the royalty ownership of wells drilled and completed on lands where both Freehold and Canpar hold the mineral rights.

At December 31, 2017, there was $nil (2016 – $nil) in accounts receivable relating to transactions with Canpar. At December 31, 2017, there was $0.1 million (2016 – $nil) in accounts payable and accrued liabilities relating to transactions with Canpar.

**(d) CN Pension Trust Funds**

Concurrent with the closing of the bought deal public equity offering completed by Freehold on May 25, 2016, CN Pension Trust Funds invested approximately $20 million through the purchase of 1,732,000 common shares on a non-brokered private placement basis. The price paid per common share by CN Pension Trust Funds pursuant to the private placement was the same price paid per common share by purchasers pursuant to the bought deal public equity offering.

All amounts owing to/from the Manager, Rife, and Canpar are unsecured, non-interest bearing and due on demand. All transactions were in the normal course of operations and were measured at the amount of consideration established and agreed to by both parties.

Expenses relating to compensation for key management personnel, considered to be Freehold's Board and Senior Management, are as follows:

### Key Management Personnel Compensation

| ($000s) | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Short-term benefits (including employee wages and directors fees) | 1,143 | 966 |
| Share based compensation | 705 | 640 |
| Total | 1,848 | 1,606 |

## Interest and Financing

In 2017 interest and financing expense decreased due to lower average debt levels. The average effective interest rate on advances under our credit facilities during 2017 was 2.9% (2016 – 2.9%).

### Interest and Financing

| ($000s, except as noted) | 2017 | 2016 | Change |
|---|---|---|---|
| Interest on operating line or other | 1 | 5 | -80% |
| Interest on long-term debt | 2,603 | 4,573 | -43% |
| Interest and financing expense | 2,604 | 4,578 | -43% |
| Per boe ($) | 0.58 | 1.02 | -43% |

## Depletion and Depreciation

Petroleum and natural gas interests, including the costs of production equipment, future capital costs, estimated decommissioning costs, and directly attributable general and administrative costs, are depleted on the unit-of-production method based on estimated proved plus probable oil and gas reserves (see Critical Accounting Estimates). Reserves are independently evaluated at year-end. For December 31, 2017, the estimate of proved plus probable reserves was based on the independent evaluation dated December 31, 2017. The increase in depletion from 2016 to 2017 is a result of increased production volumes and the effect of acquisitions and dispositions on our reserves.

### Depletion and Depreciation

| ($000s, except as noted) | 2017 | 2016 | Change |
|---|---|---|---|
| Depletion and depreciation | 108,227 | 104,159 | 4% |
| Per boe ($) | 24.01 | 23.29 | 3% |

## Income Tax

As a corporation, taxable income is based on revenues (which will vary depending on commodity prices and production volumes) less allowable expenses including claims for both accumulated tax pools and tax pools associated with current year expenditures. In 2017 corporate federal and provincial income tax rates for Freehold were approximately 27% (2016 – 27%).

In 2017 Freehold had no current tax expense (2016 - $nil) and deferred tax expense was $4.8 million (2016 - $3.1 million recovery), as the use of tax pools offset Freehold's income. Freehold has a deferred income tax asset of $21.5 million at December 31, 2017 as a result of accumulated tax pools.

## Tax Pools

We are entitled to claim certain tax deductions available to all owners of oil and gas properties. Freehold's tax pools decreased to $966.4 million at the end 2017 (from $1,028.0 million at the end of 2016), as additions through acquisitions did not offset their application against 2017 income. The tax pools below are deductible at various rates.

### Tax Pools (1)

| ($000s) | 2017 | 2016 | Change |
|---|---|---|---|
| Canadian oil and gas property expense (10% declining balance) | 728,439 | 747,912 | -3% |
| Canadian development expense (30% declining balance) | 44,004 | 60,867 | -28% |
| Capital cost allowance (generally 25%) | 14,287 | 24,864 | -43% |
| Share issue costs | 12,097 | 17,917 | -32% |
| Non-capital losses | 167,615 | 176,445 | -5% |
| Total | 966,442 | 1,028,005 | -6% |

(1) These amounts, subject to review by Canada Revenue Agency, represent Freehold's direct tax pools as well as the tax pools of its subsidiaries.

## Impairment, Impairment Reversal and Gain on Working Interest Dispositions

In December 2017, Freehold signed an agreement to sell its Pembina Cardium Unit No. 9 working interest property in Alberta in exchange for estimated proceeds of $8.2 million (including adjustments) and an acquisition of a new 4% GORR on the same property. At December 31, 2017, this working interest property was classified as assets held for sale as it was highly probable that its carrying value would be received through a sales transaction rather than continued use. At December 31, 2017, this working interest asset was recorded on the consolidated financial statements at the lower of carrying value and management's best estimate of its fair value less costs to sell resulting in Freehold recording an impairment of $6.3 million. Freehold reclassified its new recoverable estimated net book value of $13.8 million from its Other Working Interest cash generating unit (CGU) in petroleum and natural gas interests to assets held for sale. In addition, Freehold reclassified its proportionate share of decommissioning liabilities of $3.7 million to liabilities related to assets held for sale. In February 2018 Freehold closed the transaction.

In April 2017, Freehold closed the sale of working interest properties in its Southeast Saskatchewan Working Interest CGU for proceeds of $29.0 million (including adjustments). In conjunction with these transactions, Freehold recognized a gain on working interest dispositions of $14.9 million. The gain was based on $29.1 million of proceeds received, minor adjustments of $0.1 million, the removal of assets held for sale of $18.9 million and the removal of liabilities related to assets held for sale of $4.8 million. At March 31, 2017, based on the anticipated sale proceeds, Freehold reviewed the carrying value of the Southeast Saskatchewan Working Interest CGU for any reversal of impairment, as this CGU had a previous impairment charge. The recoverable amount was estimated using a fair value less cost to sell calculation based on the estimated sales price. As a result, there was an impairment reversal of $5.6 million recognized at the time of disposition, representing the maximum amount of impairment reversal able to be taken, made up of the original $8.0 million impairment estimate recorded in 2015 net of $2.4 million depletion calculated as if the impairment never occurred.

At December 31, 2017, Freehold tested the remaining working interest properties in its Other Working Interest CGU for impairment due to existing market conditions. Freehold estimated the recoverable amount as the value in use based on discounted future net cash flows of proved and probable reserves using forecast prices and costs, discounted between 15% and 25% (pre-tax). In determining the discount rate, Freehold considered the resource composition of the remaining assets including reserve type, operating expense and future development plans. The estimated recoverable amount was based on Freehold's December 31, 2017 external reserve report. Management recognizes that all assumptions and estimates affecting the value are subject to a high degree of uncertainty. Freehold recognized a non-cash impairment charge of $9.9 million as the carrying value exceeded the estimated value in use. The Other Working Interest CGU contains all of Freehold's working interest properties widespread across Western Canada. The estimated recoverable amount of this CGU at December 31, 2017 is $14.7 million.

The following table summarizes impairments and impairment reversal for 2017:

| ($000s) | **Cash Generating Unit** | **Impairment (reversal)** |
|---|---|---|
| Southeast Saskatchewan working interest properties | Southeast Saskatchewan Working Interest | (5,625) |
| Pembina Cardium Unit No. 9 | Other Working Interest | 6,323 |
| Year-end impairment | Other Working Interest | 9,911 |
| Total | | 10,609 |

## Other Loss

In May 2009, a statement of claim was filed against Freehold for $9 million. The claim involved disputed land interests and royalty obligations. During the year ended December 31, 2016 Freehold settled the claim with a $0.9 million payment and removed $0.2 million of associated accounts receivable, recognizing a total loss of $1.1 million.

# Liquidity and Capital Resources

We define capital as long-term debt, shareholders' equity, and working capital. We manage our capital structure taking into account operating activities, debt levels, debt covenants, acquisitions, capital expenditures, DRIP participation, dividend levels, and taxes, among others. We also consider changes in economic conditions and commodity prices as well as the risk characteristics of our assets. We have a depleting asset base, and ongoing development activities and acquisitions are necessary to replace production and extend reserve life. From time to time, we may issue shares or adjust capital spending to manage current and projected debt levels.

## Operating Activities

In 2017 Freehold generated net income of $12.2 million compared to an $11.2 million net loss in 2016. The increase in net income was largely the result of higher revenues, the $14.9 million gain on working interest dispositions and lower operating expenses. Offsetting these positive items was the $10.6 million net impairment expense, an increase in depletion and depreciation and the deferred income tax expense.

Funds from operations in 2017 was $123.8 million versus $94.2 million in 2016. The increase was largely the result of higher revenues caused by higher oil prices. Another key element to the improvement was lower operating expenses from our working interest dispositions. We consider funds from operations to be a key measure of operating performance as it demonstrates Freehold's ability to generate necessary funds to fund capital expenditures, sustain dividends and repay debt. We believe that such a measure provides a useful assessment of Freehold's operations on a continuing basis by eliminating certain non-cash charges. Funds from operations per share is calculated based on the weighted average number of shares outstanding consistent with the calculation of net income (loss) per share.

| ($000s, except as noted) | 2017 | 2016 | Change |
|---|---|---|---|
| Net income (loss) | 12,218 | (11,163) | -209% |
| Per share, basic and diluted ($) | 0.10 | (0.10) | -200% |
| Funds from operations | 123,788 | 94,211 | 31% |
| Per share ($) | 1.05 | 0.85 | 24% |

## Financing Activities

We retain working capital primarily to fund capital expenditures or acquisitions and reduce bank indebtedness. In the oil and gas industry, accounts receivable from industry partners are typically settled in the following month. However, due to administrative issues, payments to royalty owners are often delayed longer. Also, working capital can fluctuate significantly due to volume and price changes at each period end, unpaid capital expenditures and asset and liability reclassifications. Working capital at December 31, 2017 was $21.4 million, up $10.6 million from year-end 2016, due to the Pembina Cardium Unit No. 9 disposition in 2018 which resulted in a reclassification of values to assets held for sale and liabilities related to assets held for sale (see Impairment, Impairment Reversal and Gain on Working Interest Dispositions). The increase in working capital was offset slightly by inclusion of the current portion of decommissioning liability of $1.4 million.

### Components of Working Capital

| | As at December 31 | | |
|---|---|---|---|
| ($000s) | 2017 | 2016 | Change |
| Cash | 284 | 892 | -68% |
| Accounts receivable | 25,952 | 24,064 | 8% |
| Assets held for sale | 13,810 | - | - |
| Current assets | 40,046 | 24,956 | 60% |
| Dividends payable | (5,908) | (4,716) | 25% |
| Accounts payable and accrued liabilities | (7,206) | (9,219) | -22% |
| Current portion of share based compensation | (399) | (182) | 119% |
| Current portion of decommissioning liabilities | (1,444) | - | - |
| Liabilities related to assets held for sale | (3,710) | - | - |
| Current liabilities | (18,667) | (14,117) | 32% |
| Working capital | 21,379 | 10,839 | 97% |

At December 31, 2017, Freehold had a $165 million extendible revolving term credit facility with a syndicate of four Canadian chartered banks, on which $90 million was drawn. In addition, Freehold had available a $15 million extendible revolving operating facility.

The facilities are secured with $400 million demand debentures over most of Freehold’s petroleum and natural gas assets but do not contain any financial covenants. The lenders at any time can request a redetermination of the borrowing base, which may require a repayment to the lenders within 90 days of receiving notice, of an amount that the indebtedness is in excess of the redetermined borrowing base. Freehold's borrowing base is dependent on the lenders review and interpretation of Freehold's reserves and future commodity prices. During the second quarter 2017 the annual review was completed. The next renewal will occur by May 31, 2018. In the event that the lenders do not consent to an extension, the revolving credit facility would revert to a one-year, non-revolving term facility with repayment due at the termination date. Borrowings under the facilities bear interest at the bank's prime lending rate, bankers' acceptance or LIBOR rates plus applicable margins and standby fees.

In 2017 net debt was reduced to $68.6 million at year end from $73.2 million a year prior. Net debt was affected by our acquisitions, dispositions, free cash flow in excess of our dividends and the change in working capital mentioned above.

## Debt Analysis

| ($000s) | 2017 | 2016 | Change |
|---|---|---|---|
| Long-term debt | 90,000 | 84,000 | 7% |
| Short-term debt (operating line) | - | - | - |
| Total debt | 90,000 | 84,000 | 7% |
| Working capital | (21,379) | (10,839) | 97% |
| Net debt | 68,621 | 73,161 | -6% |

We are bound by non-financial covenants on our credit facilities and we monitor these monthly to ensure compliance. Under our credit facility, we are restricted from declaring dividends if we are or would be in default under the credit facility or if our borrowings thereunder exceed our borrowing base. As at December 31, 2017, we were in compliance with all such covenants.

Net debt to funds from operations was 0.6 times and net debt was 8% of total capitalization at the end of 2017.

## Financial Leverage and Coverage Ratios

| | 2017 | 2016 | Change |
|---|---|---|---|
| Net debt to trailing funds from operations (times) | 0.6 | 0.8 | -25% |
| Net debt to dividends (times) | 1.0 | 1.2 | -17% |
| Dividends to interest expense (times) | 26 | 13 | 100% |
| Net debt to net debt plus equity (%) | 8 | 8 | - |

## Non-Derivative Financial Liabilities

Freehold's non-derivative financial liabilities include its dividends payable, accounts payable and accrued liabilities, current portion of share based compensation payable, current portion of decommissioning liability and long-term debt. Freehold has no derivative financial liabilities.

The following table outlines cash flows associated with contractual maturities of Freehold's non-derivative financial liabilities as at December 31, 2017.

| ($000s) | Less than 1 Year | 2-3 Years | Total |
|---|---|---|---|
| Dividends payable | 5,908 | - | 5,908 |
| Accounts payable and accrued liabilities | 7,206 | - | 7,206 |
| Current portion of share based compensation payable | 399 | 1,974 | 2,373 |
| Current portion of decommissioning liability | 1,444 | - | 1,444 |
| Long-term debt | - | 90,000 | 90,000 |
| Total | 14,957 | 91,974 | 106,931 |

## Shareholders' Capital

As at December 31, 2017 and March 8, 2018 there were 118,182,667 shares outstanding. During 2017, Freehold issued 220,000 shares (2016 – 287,648) for payment of the management fee (see Related Party Transactions). During 2017 there were 44,393 shares issued for redemption of DSUs (2016 – 59,198) (see Share Based Compensation).

On May 25, 2016 Freehold closed a bought deal equity offering, issuing 16,428,900 common shares and a private equity offering with CN Pension Trust Funds (see Related Party Transactions) issuing 1,732,000 common shares, both at a price of $11.55 per share for gross proceeds of $209.8 million. The issue costs including the underwriter fees were $8.0 million ($5.8 million net of a tax effect). The funds were used for a royalty transaction which closed on the same date and to repay a portion of bank indebtedness.

On November 30, 2016, the rights of holders of trust units of Freehold Royalty Trust not deposited on or prior to this date have been terminated. Therefore, for the year ended December 31, 2016, Freehold cancelled 17,684 common shares and received $0.1 million for the return of related unclaimed accumulated dividends.

The amended and restated DRIP allows for the issuance of shares from treasury at a 5% discount to market (i.e. 95% of the weighted average closing price for the 10 trading days preceding each payment date). Effective with the August 31, 2016 dividend the Board approved the suspension of the DRIP pending further notice. In 2016, prior to suspension, 488,060 shares were issued from treasury.

For the year ended December 31, 2016, DSUs were excluded from the calculation of diluted net loss per share as their effect was anti-dilutive.

## Shares Outstanding

| | December 31, 2017 | | December 31, 2016 | |
|---|---|---|---|---|
| | Shares | Amount ($000s) | Shares | Amount ($000s) |
| Balance, beginning of year | 117,918,274 | 1,263,796 | 98,940,152 | 1,050,494 |
| Issued for dividend reinvestment plan | - | - | 488,060 | 4,997 |
| Issued for payment of management fee | 220,000 | 3,043 | 287,648 | 3,543 |
| Issued for deferred share unit plan redemption | 44,393 | 752 | 59,198 | 1,066 |
| Cancelled | - | - | (17,684) | (214) |
| Issued for equity offering | - | - | 18,160,900 | 209,759 |
| Issue costs, net of tax effect | - | - | - | (5,849) |
| Balance, end of year | 118,182,667 | 1,267,591 | 117,918,274 | 1,263,796 |

## Dividend Policy

The Board reviews and determines the monthly dividend rate on a quarterly basis, or as conditions necessitate, after considering expected commodity prices, foreign exchange rates, economic conditions, production volumes, tax payable, and our capacity to finance operating and investing obligations. The dividend rate is established with the intent of absorbing short-term market volatility over several months. It also recognizes our intention to fund capital expenditures primarily through funds from operations and to maintain a strong balance sheet to take advantage of acquisition opportunities and withstand potential commodity price declines.

The payment of dividends by a corporation is governed by the liquidity and insolvency tests described in the *Business Corporations Act* (Alberta) (ABCA). Pursuant to the ABCA, after the payment of a dividend, we must be able to pay our liabilities as they become due and the realizable value of our assets must be greater than our liabilities and the legal stated capital of our outstanding securities. As at December 31, 2017 and 2016 our legal stated capital was $1.0 billion.

### 2017 Dividends Declared

| Record Date | Payment Date | Dividend Amount ($ per share) |
|---|---|---|
| January 31, 2017 | February 15, 2017 | 0.04 |
| February 28, 2017 | March 15, 2017 | 0.04 |
| March 31, 2017 | April 17, 2017 | 0.05 |
| April 30, 2017 | May 15, 2017 | 0.05 |
| May 31, 2017 | June 15, 2017 | 0.05 |
| June 30, 2017 | July 17, 2017 | 0.05 |
| July 31, 2017 | August 15, 2017 | 0.05 |
| August 31, 2017 | September 15, 2017 | 0.05 |
| September 30, 2017 | October 16, 2017 | 0.05 |
| October 31, 2017 | November 15, 2017 | 0.05 |
| November 30, 2017 | December 15, 2017 | 0.05 |
| December 31, 2017 | January 15, 2018 | 0.05 |
| **Total** | | **0.58** |

Dividends declared in 2017 totaled $68.5 million ($0.58 per share), up from $59.5 million ($0.54 per share) in 2016. The monthly dividend increased by 25% from $0.04 per share to $0.05 per share for the dividend declared on March 31, 2017.

From inception of Freehold Royalty Trust in 1996 to December 31, 2017, Freehold distributed $1.6 billion ($31.05 per share) to our shareholders. Freehold's dividends are designated as eligible dividends for Canadian income tax purposes.

### Accumulated Dividends[1]

| | 2017 | 2016 | Change |
|---|---|---|---|
| Dividends declared ($000s) | 68,479 | 59,502 | 15% |
| Accumulated, beginning of year | 1,485,473 | 1,425,971 | 4% |
| Accumulated, end of year | 1,553,952 | 1,485,473 | 5% |
| Dividends per share ($) [2] | 0.58 | 0.54 | 7% |
| Accumulated, beginning of year | 30.47 | 29.93 | 2% |
| Accumulated, end of year | 31.05 | 30.47 | 2% |

(1) Accumulated dividends reflect distributions paid on trust units of Freehold Royalty Trust (the predecessor of Freehold) from 1996 through 2010 and dividends paid on common shares of Freehold from 2011 onwards.
(2) Based on the number of shares issued and outstanding at each record date.

The following tables show reconciliations of funds from operations and dividends. In 2017 Freehold's basic payout ratio was 55% and its adjusted payout ratio was 58%, exhibiting that dividend payments are being made within our means, with excess free cash flow being used to repay debt and fund acquisitions (see Non-GAAP Financial Measures).

### Dividends Analysis

| ($000s) | 2017 | 2016 | Change |
|---|---|---|---|
| Dividends paid in cash | 67,307 | 56,582 | 19% |
| Dividends paid in shares (DRIP) | - | 4,997 | -100% |
| Total dividends paid [1] | 67,307 | 61,579 | 9% |
| | | | |
| Dividends declared | 68,479 | 59,502 | 15% |
| Funds from operations | 123,788 | 94,211 | 31% |
| Capital expenditures | 4,864 | 5,218 | -7% |
| | | | |
| Basic payout ratio [2] | 55% | 63% | -13% |
| Adjusted payout ratio [3] | 58% | 66% | -12% |

(1) Based on the dividend payment date which is generally on the 15th day of the month following the month it was declared.
(2) Dividends declared as a percentage of funds from operations (see Non-GAAP Financial Measures).
(3) Dividends paid in cash plus capital expenditures as a percentage of funds from operations (see Non-GAAP Financial Measures).

### Reconciliation of Dividends Declared

| ($000s) | 2017 | 2016 | Change |
|---|---|---|---|
| Funds from operations | 123,788 | 94,211 | 31% |
| Proceeds from the DRIP | - | 4,997 | -100% |
| Issuance of shares, net of issue costs | - | 201,747 | -100% |
| Debt addition (repayment) | 6,000 | (68,000) | -109% |
| Acquisitions | (86,743) | (162,590) | -47% |
| Capital expenditures | (4,864) | (5,218) | -7% |
| Working interest dispositions | 32,419 | - | - |
| Working capital change | (2,121) | (5,645) | -62% |
| Dividends declared | 68,479 | 59,502 | 15% |

## Investing Activities

### Acquisitions

We pursue opportunities to augment our production and reserves, primarily targeting royalty interests. Freehold's acquisition strategy targets individual properties or groups of properties with a focus on royalty interests. The key criteria are:

- quality assets;
- attractive returns;
- acceptable risk profile; and
- long economic life.

Freehold expended $86.7 million on acquisitions in 2017 (2016 - $162.6 million). In February 2017 Freehold closed an acquisition of various gross overriding royalties and mineral title lands in the greater Dodsland area of Saskatchewan for $33.7 million (including adjustments). In December 2017 Freehold closed an acquisition of a new 2% GORR in the Cardium in the greater Pembina area of Alberta for $52.3 million (including adjustments) and the assignment of certain minor working interest properties. In addition, for the year ended December 31, 2017, Freehold had minor acquisitions and adjustments on previous acquisitions of $0.7 million.

### Capital Expenditures

In 2017, development expenditures of $4.9 million amounted to 4% of funds from operations, a 7% reduction from 2016 levels, as there were reduced capital commitments on our largely non-operated properties.

In the upstream oil and gas sector, because of the nature of reserve reporting, natural reservoir depletion, and the risks involved in capital investment, it is not possible to distinguish between capital spent on maintaining productive capacity and capital spent on growth opportunities. Therefore, maintenance capital is not disclosed separately from development capital spending.

| ($000s, except as noted) | 2017 | 2016 | Change |
|---|---|---|---|
| Development drilling and other | 4,049 | 2,990 | 35% |
| Plant and facilities | 815 | 2,228 | -63% |
| Total capital expenditures | 4,864 | 5,218 | -7% |

### Working Interest Dispositions

In April 2017, Freehold closed the sale of working interest properties in its Southeast Saskatchewan Working Interest CGU for proceeds of $29.0 million, including adjustments (see Impairment, Impairment Reversal and Gain on Working Interest Dispositions). In addition, for the year ended December 31, 2017, Freehold sold additional minor working interest properties for $3.4 million (including adjustments).

## Decommissioning Liability

We have no decommissioning liability on our royalty interest properties. Our decommissioning liability results from our responsibility to abandon and reclaim our net share of all working interest properties. The undiscounted value of our total decommissioning liability is estimated to be $19.3 million (2016 - $36.3 million). Payments to settle the obligations are expected to occur continuously over the next 52 years, with the majority being settled within 10 years. At December 31, 2017, a risk-free rate of 2.2% (2016 – 2.3%) and an inflation rate of 2.0% (2016 – 2.0%) were used to calculate the fair value. The value of the decommissioning liability at December 31, 2017 was $15.5 million (2016 – $23.7 million) with the current portion of liability being $1.4 million (2016 – $nil).

# Business Risks and Mitigating Strategies

Our operations are subject to some of the same industry risks and conditions faced by oil and gas companies. The most significant of these include the following:

- fluctuations in commodity prices and quality differentials as a result of weather patterns, world and North American market forces or shifts in the balance between supply and demand for crude oil and gas;
- access to pipelines or other transportation methods for bringing oil and natural gas to market;
- variations in currency exchange rates;
- imprecision of reserve estimates and uncertainty of depletion and recoverability of reserves. Our reserves will deplete over time through continued production and we and our industry partners and royalty payors may not be able to replace these reserves on an economic basis;
- reliance on royalty payors to drill and produce on our lands and their ability to pay their obligations;
- industry activity levels and intense competition for land, goods and services, and qualified personnel;
- stock market volatility and the ability to access sufficient capital from internal and external sources;
- risk associated with volatility in global financial markets;
- risk associated with the renegotiation of our credit facility;
- operational or marketing risks resulting in delivery interruptions, delays or unanticipated production declines;
- changes in government regulations, taxation, and royalties; and
- safety and environmental risks.

For a more detailed description of risk factors, please see our Annual Information Form, filed on SEDAR.

We employ the following strategies to mitigate these risks:

- Our diversified revenue stream limits the size of any one property with respect to our total assets.
- We are not liable for abandonment and reclamation costs on our royalty lands.
- Due to our high percentage of royalty lands, we have one of the lowest all-in cost structures of our peer group. In addition, we maintain a focus on controlling direct costs to maximize profitability.
- We negotiate agreements that provide mechanisms to ensure that our interests are protected.
- Systems and processes are in place to identify any unpaid or incorrect revenues.
- We maintain a dedicated compliance function, with a comprehensive auditing program, to ensure that the terms of the various agreements are followed. During 2017, our audit staff issued audit exception queries amounting to $9.5 million, bringing the total amount of audit exception queries since 1997 to $85.9 million, of which we have successfully recovered $69.4 million.
- We adhere to strict investment criteria for acquisitions, seeking quality royalty properties that have attractive returns, acceptable risk profiles and long economic lives.

- We market our products to a diverse range of buyers or with our diverse range of royalty payors. Currently, we do not have any commodity price, exchange rate, or interest rate hedging programs in place.
- We employ a qualified Manager that has many years of experience and knowledge in managing our assets.
- We maintain levels of liability insurance that meet or exceed industry standards.
- We employ a conservative approach to debt management. As circumstances warrant, we allocate a portion of funds from operations to debt repayment.

## Environmental Regulation and Risk

The oil and gas industry is currently subject to environmental regulations pursuant to provincial and federal legislation. Such legislation provides for restrictions and prohibitions on the release or emission of various substances produced in association with certain oil and gas industry operations. In addition, such legislation requires that well and facility sites be abandoned and reclaimed to the satisfaction of provincial authorities. Compliance with such legislation can require significant expenditures and a breach of such requirements may result in suspension or revocation of necessary licenses and authorizations, civil liability for pollution damage, and the imposition of material fines and penalties. It is reasonably likely that the trend towards stricter standards in environmental legislation and regulation will continue. Given the evolving nature of the debate related to climate change and the control of greenhouse gases and resulting requirements, it is not possible to predict the impact of those requirements on our operations and financial condition. For information about climate change and other environmental regulations, see “Industry Conditions” in our Annual Information Form.

# Controls and Accounting Matters

In compliance with National Instrument 52-109 *Certification of Disclosure in Issuers’ Annual and Interim Filings* (NI 52-109), Freehold has filed certificates signed by our Chief Executive Officer (CEO) and Chief Financial Officer (CFO) that, among other things, deal with the matter of disclosure controls and procedures and internal control over financial reporting. While we believe that our disclosure controls and procedures and internal control over financial reporting provide a reasonable level of assurance, we do not expect that the controls will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objective of the control system is met.

## Disclosure Controls

As of December 31, 2017, an internal evaluation was carried out of the effectiveness of Freehold’s disclosure controls and procedures. This evaluation was performed under the supervision of, and with the participation of the CEO and the CFO. It took into consideration Freehold’s Disclosure, Insider Trading, Code of Business Conduct and Conflict of Interest, and Whistleblower policies, as well as the functioning of the Manager, the officers, the Board and Board Committees. In addition, the evaluation covered the processes, systems and capabilities relating to regulatory filings, public disclosures, and the identification and communication of material information. Based on this evaluation, management has concluded that Freehold’s disclosure controls and procedures were effective as at December 31, 2017, in ensuring that material information is made known to management in a timely manner, particularly during the period in which the annual filings were being prepared, and information required to be disclosed by Freehold in its annual filings, interim filings or other reports filed or submitted by Freehold under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation.

## Internal Control Over Financial Reporting

Our CEO and CFO are responsible for establishing and maintaining internal control over financial reporting (ICFR). They have caused ICFR to be designed under their supervision to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with Canadian GAAP. The control framework used to design ICFR is the Internal Control – Integrated Framework (2013 COSO Framework) published by The Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Under the supervision of the CEO and CFO, Freehold conducted an evaluation of the effectiveness of its ICFR as at December 31, 2017, as structured within the 2013 COSO Framework. Based on this evaluation, the CEO and CFO concluded that, as of December 31, 2017, our ICFR provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. There were no changes in our ICFR during 2017 that materially affected Freehold's ICFR.

## New Accounting Standards

### Recent Pronouncements

In May 2014, the IASB issued IFRS 15 Revenue from Contracts with Customers, which replaces IAS 11 Construction Contracts, IAS 18 Revenue, and other revenue related interpretations. The standard establishes a single revenue recognition framework that applies to contracts with customers. The effective date for adopting IFRS 15 in its entirety is January 1, 2018. Freehold has completed its review of various revenue streams and underlying contracts with customers and concluded that the adoption of IFRS 15 will not have a material effect on its consolidated financial statements. Commencing in the first quarter of 2018, Freehold will expand the disclosures in the notes to its consolidated financial statements as prescribed by IFRS 15. The new disclosure will include disaggregated revenue streams similar to what has been historically disclosed in Freehold's Management Discussion and Analysis.

In July 2014, the IASB completed a three-phase project to replace IAS 39 Financial Instruments: Recognition and Measurement with IFRS 9 Financial Instruments. The first two completed phases replaced the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. The third phase describes a new hedge accounting model. Presently and historically, Freehold has not entered into any transactions in which hedge accounting could be applied. Freehold has concluded the standard will not have a material impact on its consolidated financial statements aside from changes to classification of financial assets. The effective date for adopting IFRS 9 in its entirety is January 1, 2018.

In January, 2016, the IASB issued IFRS 16 Leases, which replaces IAS 17 Leases. The standard establishes a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. Other areas of the lease accounting model have been impacted, including the definition of a lease. Transitional provisions have been provided. The effective date for adopting IFRS 16 in its entirety is January 1, 2019. Freehold's assessment of the lease standard is ongoing and the impact, if any, on the consolidated financial statements and additional disclosure requirements is yet to be fully determined.

## Critical Accounting Estimates

Our financial statements are prepared within a framework of Canadian GAAP (being IFRS) selected by management and approved by our Board. The assets, liabilities, revenues, and expenses reported in our financial statements depend to varying degrees on estimates made by management. These estimates are based on historical experience and reflect certain assumptions about the future that are believed to be both reasonable and conservative. The more significant reporting areas are crude oil and gas reserve estimation, depletion, impairment of assets, oil and gas revenue accruals, oil and gas royalty interests, decommissioning liability, income taxes, and share based compensation. Management's judgments and estimates in these areas are based on information available from both internal and external sources, including engineers, geologists, and historical experience in similar matters. Actual results could differ from the estimates, as additional information becomes known.

An estimate is considered a critical accounting estimate if it requires management to make assumptions about matters that are highly uncertain, and if different estimates that could have been used would have a material impact. We continually evaluate the estimates and assumptions. In the normal course, changes are made to assumptions underlying all critical accounting estimates to reflect current economic conditions, and updating of historical information is used to develop the assumptions. Except as discussed in this MD&A, we are not aware of trends, commitments, events, or uncertainties that are expected to materially affect the methodology or assumptions associated with the critical accounting estimates.

### Reserve Estimates, Depletion and Impairment Testing

The current estimates of oil and gas reserves and our future capital expenditures are based on an independent evaluation conducted as of December 31, 2017. Reserve estimates are updated once a year (as at December 31) and when a significant acquisition or development is completed. At each interim reporting date, reserves are also adjusted for production. The reserve and recovery information provided are only estimates. The actual production and ultimate reserves may be greater than or less than the estimates and the differences may be material.

Petroleum and natural gas interests, including the cost of production equipment, future capital costs, estimated decommissioning costs and directly attributable general and administrative costs are depleted on the unit-of-production method based on estimated proved plus probable oil and gas reserves. Reserves are converted to equivalent units on the basis of relative energy content. An increase in estimated proved plus probable oil and gas reserves would result in a corresponding reduction in the depletion rate.

At each reporting date, Freehold assesses groups of assets or CGUs for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. If any such indication of impairment exists, Freehold makes an estimate of its recoverable amount. Where the carrying amount of a group of assets exceeds its recoverable amount, the assets are considered impaired and written down. Impairments can be reversed if the impairment indicators have been reversed. Indicators and recoverable amounts are primarily estimates from independent sources. The determination of CGUs is subject to management judgment.

### Oil and Gas Revenue Accruals and Royalty Interests

Freehold follows the accrual method of accounting, making estimates in its financial and operating results. This may include estimates of revenues, royalties, production and other expenses and capital items related to the period being reported, for which actual results have not yet been received. We expect that these accrual estimates will be revised, upwards or downwards, based on the receipt of actual results. We have no operational control over our royalty lands, and we primarily hold small interests in several thousand wells. Thus, obtaining timely production data from the well operators is extremely difficult. As a result, we use government reporting databases and past production receipts to estimate revenue accruals.

Significant judgment is required to determine the interests of royalty properties in areas where mineral rights are shared with Canpar (see Related Party Transactions). We use publicly available information on geological formations to apportion revenues between the entities in accordance with the respective party's interests. As new geological information becomes available and as part of our ongoing internal audit activities, we periodically revise these allocations and consideration is transferred to reflect the changes.

## Decommissioning Liability

Freehold measures decommissioning liability as the present value of management's best estimate of the expenditure required to settle the obligation at the reporting date using a risk-free discount rate. This estimate is recognized when a legal or constructive obligation arises and is recorded as both a short and long-term liability, with a corresponding increase in the carrying value of the petroleum and natural gas working interest asset. The capitalized amount is depleted on a unit-of-production method over the life of the reserves. At each reporting date, the passage of time and changes to estimates results in liability changes and the amount of accretion is charged against current period income.

In determining our decommissioning liability, we are required to make a significant number of estimates with respect to activities that will occur in many years to come. In arriving at the recorded amount of the decommissioning liability, numerous assumptions are made with respect to ultimate settlement amounts, inflation factors, risk-free discount rates, timing of settlement and expected changes in legal, regulatory, environmental and political environments. The decommissioning liability also results in an increase to the carrying cost of capital assets. The obligation accretes to a higher amount with the passage of time as it is determined using discounted present values. A change in any one of the assumptions could affect the estimated future obligation and in return, net income. It is difficult to determine the impact of a change in any one of our assumptions. As a result, a reasonable sensitivity analysis cannot be performed.

## Income Taxes

We follow the balance sheet method of accounting for income taxes. Under this method, income tax liabilities and assets are recognized for the estimated tax consequences attributable to differences between the amounts reported in the financial statements and their respective tax bases, using enacted or substantially enacted income tax rates. The effect of a change in income tax rates on deferred income tax liabilities and assets is recognized in income in the period that the change occurs. The actual amount of income tax may be greater than or less than the estimates and the differences may be material.

## Share Based Compensation

In 2017, Freehold adopted a new long-term incentive plan (LTIP) to replace the previous long-term incentive plan for the employees of Rife Resources Ltd. (Rife) through the Manager of Freehold, Rife Resources Management Ltd. (see Related Party Transactions). Grants will no longer be made under the previous plan but pre-existing grants will continue until vesting and payout occurs.

Freehold's new long-term incentive plan consists of grants of performance share units (PSUs) and restricted share units (RSUs). Underlying each PSU and RSU is one notional Freehold common share. The notional Freehold common shares are adjusted whenever a dividend is paid by Freehold. Upon vesting of the RSUs the holder is entitled to an amount equal in value to the notional Freehold common shares (as adjusted for dividends paid) underlying such RSUs. The value of the notional Freehold common shares is based on the volume weighted average trading price of Freehold common shares on the TSX for the five trading days prior to the settlement date of such RSUs. Generally, one-third of the granted RSUs will vest on each of the first, second and third anniversaries of the date of grant.

For PSUs, the notional Freehold common shares and value are calculated in the same manner as the RSUs, but with the additional application of a performance multiplier. The metrics used for determining the performance multiplier (which can range from 0 to 2 times) are at the discretion of Freehold's Board of Directors at the time of grant. Generally, all of the granted PSUs will vest on the third anniversary of the date of grant.

Since participants receive a cash payment on a fixed vesting date, a liability is determined and recognized as services are rendered based on the fair value of the total rights at each period end. The valuation incorporates the consideration of the Freehold common share price, the number of notional Freehold common shares outstanding at each period end, an estimated performance multiplier, if applicable, and an estimated forfeiture rate.

The previous LTIP uses a combination of the value of phantom Rife shares and Freehold shares as the basis for rights, which are granted annually at the discretion of the directors of Rife and vest at the end of a three-year period. Dividends to shareholders paid by Freehold during the vesting period are assumed to be reinvested in notional rights on the dividend payment date. Since participants in the LTIP receive a cash payment on a fixed vesting date, a liability is determined and recognized as services are rendered based on the fair value of the rights at each period end. The valuation incorporates the consideration of the share price, the number of rights outstanding at each period end, an estimated performance multiplier (0.25 to 1.5 times the market value) and an estimated forfeiture rate.

Compensation expense is recognized over the vesting period. If factors change actual payments resulting from the LTIP can vary significantly from amounts expensed in prior periods.

## Forward-Looking Statements

Certain statements contained in this MD&A constitute forward-looking statements. These statements relate to future events or our expectations of future performance. All statements other than statements of historical fact may be forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "plan", "continue", "estimate", "expect", "may", "will", "forecast", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar expressions (including the negatives thereof). These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements. We believe the expectations reflected in those forward-looking statements are reasonable but no assurance can be given that these expectations will prove to be correct and, as such, forward-looking statements included in this MD&A should not be unduly relied upon. These forward-looking statements are provided to allow readers to better understand our business and prospects.

In particular, this MD&A contains forward-looking statements pertaining to the following:

- our outlook for commodity prices including supply and demand factors relating to crude oil, heavy oil, and natural gas;
- light/heavy oil price differentials;
- changing economic conditions;

- OPEC reaffirming production quotas through the first half of 2018 aiding in maintaining WTI prices between US$50-$70/bbl
- projected drilling in Canada in 2018;
- the expectation that activity levels will remain strong on our royalty lands in 2018;
- the properties underlying the royalties acquired on February 28, 2018 having multiple years of development planned;
- the March 7, 2018 Weyburn Unit royalty acquisition having multi-year upside associated with expansion of the existing CO2 enhanced oil recovery process and additional infill drilling;
- the March 7, 2018 Mitsue Gilwood Sand Unit #1 royalty acquisition having further value enhancing opportunities through waterflood optimization, reactivations and infill drilling;
- the March 7, 2018 royalty acquisition adding 110 boe/d and $2.6 million in annualized operating income at strip pricing;
- the March 7, 2018 royalty acquisition shallowing Freehold's already low corporate decline;
- our strategies and the expectation that those strategies will sustain production and reserves life;
- our acquisition criteria and the intent that such criteria will result in acquisitions being accretive to shareholders;
- foreign exchange rates;
- industry drilling and development activity on our royalty lands;
- development of our working interest properties;
- Freehold's decommissioning liability and timing of payment thereof;
- forecast 2018 production, including product mix and percentage from royalties;
- forecast 2018 percentage of operating income from royalties;
- forecast 2018 adjusted payout ratio;
- forecast 2018 year end net debt to funds from operations;
- average production and contribution from royalty lands;
- key operating assumptions;
- amounts and rates of income taxes and timing of payment thereof;
- expected production additions from our audit function;
- our tax pools and the expected tax horizon;
- our dividend policy and expectations for future dividends;
- treatment under governmental regulatory regimes and tax laws; and
- our assessment of litigation risk.

Our actual results could differ materially from those anticipated in these forward-looking statements because of many factors, the most significant of which are as follows:

- volatility in market prices for crude oil and natural gas;
- lack of pipeline capacity;
- currency fluctuations;
- changes in income tax laws or changes in tax laws, regulations, royalties, or incentive programs relating to the oil and gas industry;
- reliance on royalty payors to drill and produce on our lands and their ability to pay their obligations;
- uncertainties or imprecision associated with estimating oil and gas reserves;

- stock market volatility and our ability to access sufficient capital from internal and external sources;
- a significant or prolonged downturn in general economic conditions or industry activity;
- incorrect assessments of the value of acquisitions;
- competition for, among other things, capital, acquisitions of reserves, undeveloped lands and skilled personnel;
- geological, technical, drilling, and processing problems;
- environmental risks and liabilities inherent in oil and gas operations; and
- other factors discussed under Business Risks and Mitigating Strategies in this MD&A, and under Risk Factors and elsewhere in our Annual Information Form.

Readers are cautioned that the foregoing list of factors is not exhaustive.

With respect to forward-looking statements contained in this MD&A, we have made assumptions regarding, among other things, the following:

- future crude oil and natural gas prices;
- future capital expenditure levels;
- future production levels;
- future exchange rates;
- future tax rates;
- future participation rates in the DRIP;
- future legislation;
- the cost of developing and expanding our assets;
- our ability and the ability of our industry partners and royalty payors to obtain equipment in a timely manner to carry out development activities;
- our ability to market our product successfully to current and new customers;
- our expectation for the consumption of crude oil and natural gas;
- our expectation for industry drilling levels on our royalty lands;
- the impact of increasing competition;
- our ability to obtain financing on acceptable terms; and
- our ability to add production and reserves through our development and acquisition activities.

Key operating assumptions with respect to the forward-looking statements contained in this MD&A are provided in the Outlook section.

You are further cautioned that the preparation of financial statements in accordance with IFRS requires management to make certain judgments and estimates that affect the reported amounts of assets, liabilities, revenues, and expenses. These estimates may change, having either a positive or negative effect on net income, as further information becomes available and as the economic environment changes.

The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement and speak only as of the date of this MD&A. Our policy for updating forward-looking statements is to update our key operating assumptions quarterly and, except as required by law, we do not undertake to update any other forward-looking statements.

## Non-GAAP Financial Measures

Within this MD&A, references are made to terms commonly used as key performance indicators in the oil and gas industry. We believe that operating income, operating netback, basic payout ratio, adjusted payout ratio, free cash flow and cash costs are useful supplemental measures for management and investors to analyze operating performance, financial leverage, and liquidity, and we use these terms to facilitate the understanding and comparability of our results of operations and financial position. However, these terms do not have any standardized meanings prescribed by GAAP and therefore may not be comparable with the calculations of similar measures for other entities.

Operating income, which is calculated as royalty and other revenue less royalties and operating expenses, represents the cash margin for product sold. Operating netback, which is calculated as average unit sales price less royalties and operating expenses, represents the cash margin for product sold, calculated on a per boe basis (see Netback Analysis).

Payout ratios are often used for dividend paying companies in the oil and gas industry to identify its dividend levels in relation to the funds it receives and uses in its capital and operational activities. Basic payout ratio is calculated as dividends declared as a percentage of funds from operations. Adjusted payout ratio is calculated as dividends paid in cash plus capital expenditures as a percentage of funds from operations.

Free cash flow is calculated by subtracting capital expenditures from funds from operations. Free cash flow is a measure often used by dividend paying companies to determine cash available for payment of dividends, paying down debt or investment.

| ($000s) | 2017 | 2016 | Change |
|---|---|---|---|
| Funds from operations | 123,788 | 94,211 | 31% |
| Capital expenditures | (4,864) | (5,218) | -7% |
| Free cash flow | 118,924 | 88,993 | 34% |

Cash costs is a total of certain cash expenses in the statement of income (loss) deducted in determining funds from operations. For Freehold cash costs are identified as royalty expense, operating expense, general and administrative expense, interest expense and share based compensation payments. It is key to funds from operations, representing the ability fund capital expenditures, sustain dividends and repay debt.

| ($000s) | 2017 | 2016 | Change |
|---|---|---|---|
| Royalty expense | 1,174 | 1,317 | -11% |
| Operating expense | 11,006 | 17,630 | -38% |
| General and administrative expenses | 11,015 | 10,184 | 8% |
| Interest expense | 2,604 | 4,578 | -43% |
| Expenditures on share based compensation | 442 | 490 | -10% |
| Total cash costs | 26,241 | 34,199 | -23% |

We refer to various per boe figures which provide meaningful information on our operational performance. We derive per boe figures by dividing the relevant revenue or cost figure by the total volume of oil, NGL and natural gas production during the period, with natural gas converted to equivalent barrels of oil as described below.

## Conversion of Natural Gas to Barrels of Oil Equivalent (boe)

To provide a single unit of production for analytical purposes, natural gas production and reserves volumes are converted mathematically to equivalent barrels of oil (boe). We use the industry-accepted standard conversion of six thousand cubic feet of natural gas to one barrel of oil (6 Mcf = 1 barrel). The 6:1 boe ratio is based on an energy equivalency conversion method primarily applicable at the burner tip. It does not represent a value equivalency at the wellhead and is not based on either energy content or current prices. While the boe ratio is useful for comparative measures, it does not accurately reflect individual product values and might be misleading, particularly if used in isolation. As well, given that the value ratio, based on the current price of crude oil to natural gas, is significantly different from the 6:1 energy equivalency ratio, using a 6:1 conversion ratio may be misleading as an indication of value.

# Management's Report

The accompanying consolidated financial statements and other financial information in this Financial Report have been prepared by management, who is responsible for their integrity, consistency, objectivity and reliability. To fulfill this responsibility, Freehold maintains policies, procedures and systems of internal control to ensure that reporting practices and accounting and administrative procedures are appropriate to provide reasonable assurance that the assets are safeguarded, transactions are properly authorized and relevant and reliable financial information is produced.

These consolidated financial statements have been prepared in conformity with International Financial Reporting Standards and, where appropriate, reflect estimates based on management's judgment. The financial information presented throughout this Financial Report is generally consistent with the information contained in the accompanying consolidated financial statements.

Independent auditors, KPMG LLP, were appointed by the shareholders to perform an examination of the corporate and accounting records so as to express an opinion on the consolidated financial statements. Their examination included tests and procedures considered necessary to provide reasonable assurance that the consolidated financial statements are presented fairly in accordance with International Financial Reporting Standards.

The consolidated financial statements have been further reviewed and approved by the Board of Directors acting through its Audit Committee, which is comprised of independent directors. The Audit Committee, which meets with the auditors and management to review the activities of each and reports to the Board of Directors, oversees management's responsibilities for the financial reporting and internal control systems. The auditors have full and direct access to the Audit Committee and meet periodically with the committee both with and without management present to discuss their audit and related findings.

| | |
|---|---|
| Thomas J. Mullane | Darren G. Gunderson |
| President and Chief Executive Officer | Vice-President, Finance and Chief Financial Officer |

March 8, 2018

# Independent Auditors' Report

**To the Shareholders of Freehold Royalties Ltd.**

We have audited the accompanying consolidated financial statements of Freehold Royalties Ltd., which comprise the consolidated balance sheets as at December 31, 2017 and December 31, 2016, the consolidated statements of income (loss) and comprehensive income (loss), changes in shareholders' equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Freehold Royalties Ltd. as at December 31, 2017 and December 31, 2016, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Professional Accountants
March 8, 2018
Calgary, Canada

# Consolidated Balance Sheets

| ($000s) | December 31, 2017 | December 31, 2016 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash | $ 284 | $ 892 |
| Accounts receivable | 25,952 | 24,064 |
| Assets held for sale (note 3) | 13,810 | - |
| | 40,046 | 24,956 |
| Exploration and evaluation assets (note 4) | 75,776 | 64,019 |
| Petroleum and natural gas interests (note 5) | 818,921 | 892,120 |
| Deferred income tax asset (note 11) | 21,541 | 26,355 |
| | $ 956,284 | $ 1,007,450 |
| **Liabilities and Shareholders' Equity** | | |
| Current liabilities: | | |
| Dividends payable | $ 5,908 | $ 4,716 |
| Accounts payable and accrued liabilities | 7,206 | 9,219 |
| Current portion of share based compensation payable (note 10) | 399 | 182 |
| Current portion of decommissioning liability (note 7) | 1,444 | - |
| Liabilities related to assets held for sale (note 3) | 3,710 | - |
| | 18,667 | 14,117 |
| Decommissioning liability (note 7) | 14,051 | 23,705 |
| Share based compensation payable (note 10) | 1,974 | 932 |
| Long-term debt (note 6) | 90,000 | 84,000 |
| Shareholders' equity: | | |
| Shareholders' capital (note 8) | 1,267,591 | 1,263,796 |
| Contributed surplus | 2,079 | 2,717 |
| Deficit | (438,078) | (381,817) |
| | 831,592 | 884,696 |
| | $ 956,284 | $ 1,007,450 |

See accompanying notes to consolidated financial statements.

On behalf of the Board of Directors of Freehold Royalties Ltd.:

Marvin F. Romanow
Director

Arthur N. Korpach
Director

# Consolidated Statements of Income (Loss) and Comprehensive Income (Loss)

| ($000s, except per share and weighted average data) | Year Ended December 31 2017 | 2016 |
|---|---|---|
| Revenue: | | |
| Royalty and other revenue (note 14) | $ 151,894 | $ 129,968 |
| Royalty expense | (1,174) | (1,317) |
| | 150,720 | 128,651 |
| Gain on working interest dispositions (note 5) | 14,866 | - |
| Other loss (note 15) | - | (1,066) |
| Expenses: | | |
| Operating | 11,006 | 17,630 |
| General and administrative | 11,015 | 10,184 |
| Share based compensation (note 10) | 1,591 | 1,208 |
| Interest and financing | 2,604 | 4,578 |
| Depletion and depreciation (note 5) | 108,227 | 104,159 |
| Impairment, net of impairment reversal (note 3, 5) | 10,609 | - |
| Accretion of decommissioning liability (note 7) | 459 | 543 |
| Management fee (note 9) | 3,043 | 3,543 |
| | 148,554 | 141,845 |
| Income (loss) before taxes | 17,032 | (14,260) |
| Deferred income tax expense (recovery) (note 11) | 4,814 | (3,097) |
| Net income (loss) and comprehensive income (loss) | $ 12,218 | $ (11,163) |
| Net income (loss) per share, basic and diluted | $ 0.10 | $ (0.10) |
| Weighted average number of shares: | | |
| Basic | 118,044,473 | 110,391,160 |
| Diluted (note 8) | 118,162,099 | 110,391,160 |

See accompanying notes to consolidated financial statements.

# Consolidated Statements of Cash Flows

| ($000s) | Year Ended December 31 2017 | 2016 |
|---|---|---|
| Operating: | | |
| Net income (loss) | $ 12,218 | $ (11,163) |
| Items not involving cash: | | |
| Depletion and depreciation | 108,227 | 104,159 |
| Gain on working interest dispositions | (14,866) | - |
| Impairment, net of impairment reversal | 10,609 | - |
| Share based compensation | 1,591 | 1,208 |
| Deferred income tax expense (recovery) | 4,814 | (3,097) |
| Accretion of decommissioning liability | 459 | 543 |
| Management fee | 3,043 | 3,543 |
| Expenditures on share based compensation | (442) | (490) |
| Decommissioning expenditures | (1,865) | (492) |
| Funds from operations | 123,788 | 94,211 |
| Changes in non-cash working capital (note 14) | (4,521) | (1,078) |
| | 119,267 | 93,133 |
| Financing: | | |
| Issuance of shares, net of issue costs | - | 201,747 |
| Long-term debt | 6,000 | (68,000) |
| Dividends paid | (67,307) | (56,582) |
| | (61,307) | 77,165 |
| Investing: | | |
| Acquisitions | (86,743) | (162,590) |
| Capital expenditures | (4,864) | (5,218) |
| Working interest dispositions | 32,419 | - |
| Changes in non-cash working capital (note 14) | 620 | (2,474) |
| | (58,568) | (170,282) |
| Increase (decrease) in cash | (608) | 16 |
| Cash, beginning of year | 892 | 876 |
| Cash, end of year | $ 284 | $ 892 |

See accompanying notes to consolidated financial statements.

# Consolidated Statements of Changes in Shareholders' Equity

| ($000s) | Year Ended December 31 2017 | 2016 |
|---|---|---|
| Shareholders' capital: | | |
| Balance, beginning of year | $ 1,263,796 | $ 1,050,494 |
| Shares issued for dividend reinvestment plan | - | 4,997 |
| Shares issued for payment of management fee | 3,043 | 3,543 |
| Shares issued for deferred share unit plan redemption | 752 | 1,066 |
| Shares cancelled | - | (214) |
| Shares issued for equity offering | - | 209,759 |
| Issue costs, net of tax effect | - | (5,849) |
| Balance, end of year | 1,267,591 | 1,263,796 |
| Contributed surplus: | | |
| Balance, beginning of year | 2,717 | 3,282 |
| Share based compensation expense | 391 | 442 |
| Deferred share unit plan redemption and other | (1,029) | (1,007) |
| Balance, end of year | 2,079 | 2,717 |
| Deficit: | | |
| Balance, beginning of year | (381,817) | (311,152) |
| Net income (loss) and comprehensive income (loss) | 12,218 | (11,163) |
| Dividends declared | (68,479) | (59,502) |
| Balance, end of year | (438,078) | (381,817) |
| | $ 831,592 | $ 884,696 |

See accompanying notes to consolidated financial statements.

# Notes to the Consolidated Financial Statements

Years ended December 31, 2017 and 2016

## 1. Basis of Presentation

Freehold Royalties Ltd. (Freehold) is a dividend-paying corporation incorporated under the laws of the Province of Alberta. Freehold's primary focus is acquiring and managing oil and gas royalties.

Freehold's principal place of business is located at 400, 144 – 4 Avenue SW, Calgary, Alberta, Canada T2P 3N4.

### a. Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). A summary of Freehold's significant accounting policies under IFRS are presented in note 2.

These consolidated financial statements were approved by the Board of Directors on March 8, 2018.

### b. Basis of measurement and principles of consolidation

These consolidated financial statements have been prepared on a historical cost basis, with the exception of certain fair value measurements noted in Significant Accounting Policies, and include the accounts of Freehold and its wholly-owned subsidiaries: 1872348 Alberta Ltd., Freehold Holdings Trust and Freehold Royalties Partnership. All inter-entity transactions have been eliminated.

### c. Use of estimates and judgment

The preparation of financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses during the reporting period. Actual results could differ as a result of using estimates.

The amounts recorded for the depletion of petroleum and natural gas properties, the provision for decommissioning liability and the amounts used in the impairment calculations are based on estimates of petroleum and natural gas reserves and future costs to develop those reserves. By their nature, these estimates of reserves, costs and related future cash flows are subject to uncertainty, and the impact on the financial statements of future periods could be material.

The decommissioning liability amounts recorded are based on estimates of inflation rates, risk-free rates, timing of abandonments and future abandonment costs, all of which are subject to uncertainty. The long-term incentive plan amounts recorded include an estimate of forfeitures and certain management assumptions. Actual results could differ as a result of using estimates.

Income tax liabilities and assets are recognized for the estimated tax consequences attributable to differences between the amounts reported in the financial statements and their respective tax bases, using enacted or substantively enacted income tax rates. The effect of a change in income tax rates on deferred income tax liabilities and assets is recognized in income in the period that the change occurs. The actual amount of income tax may be greater than or less than the estimates and the differences may be material.

The determination of a cash generating unit (CGU) and whether an acquisition transaction constitutes a business combination is subject to management judgments. The recoverability of petroleum and natural gas interests and exploration and evaluation assets are assessed at the CGU level. A CGU is the lowest level at which there are identifiable cash inflows that are largely independent of the cash inflows of other CGUs. Each acquisition transaction is reviewed by management and judgment is used when determining if the transaction met the IFRS 3 inputs and processes criteria for business combinations.

Freehold follows the accrual method of accounting, making estimates in its financial and operating results. This may include estimates of revenues, royalties, production and other expenses and capital items related to the period being reported, for which actual results have not yet been received. It is expected that these accrual estimates will be revised, upwards or downwards, based on the receipt of actual results. Freehold has no operational control over its royalty lands and primarily holds small interests in several thousand wells. Thus, obtaining timely production data from the well operators is extremely difficult. As a result, Freehold uses government reporting databases and past production receipts to estimate revenue accruals.

Significant judgment is required to determine the interests of royalty properties in areas where mineral rights are shared with a related party, Canpar Holdings Ltd. (Canpar). Freehold uses publicly available information on geological formations to apportion revenues between the entities in accordance with the respective party's interests. As new geological information becomes available and as part of its ongoing internal audit activities, Freehold periodically revises these allocations and consideration is transferred to reflect the changes.

### d. Functional and presentation currency

These consolidated financial statements are presented in Canadian dollars, which is the functional currency of Freehold and its subsidiaries.

## 2. Significant Accounting Policies

### a. Jointly controlled operations and jointly controlled assets

Some of Freehold's oil and gas activities involve jointly controlled assets. These consolidated financial statements include only Freehold's share of the jointly controlled assets and a proportionate share of the relevant revenue and related costs.

### b. Exploration and evaluation assets

Exploration and evaluation (E&E) costs are accounted for in accordance with IFRS 6, *Exploration for and Evaluation of Mineral Resources*. All E&E costs incurred after acquiring the "right to explore" are capitalized into a single cost pool. Upon determination of the technical feasibility and commercial viability of reserves, the associated E&E costs are assessed for impairment and the estimated recoverable amount is transferred to petroleum and natural gas interests. All costs incurred prior to acquiring the "right to explore" are expensed as incurred. At each reporting date, E&E costs are reviewed for indicators of impairment. If circumstances indicate the carrying amount exceeds its recoverable amount, the cost is written down to its recoverable amount and the difference is accounted for as an impairment expense. No depletion or depreciation is charged to E&E.

## c. Petroleum and natural gas interests

### Petroleum and natural gas interests

Petroleum and natural gas interests are classified under International Accounting Standard (IAS) 16 as Property, Plant and Equipment and include both working and royalty interests, stated at cost, less accumulated depletion and accumulated impairment losses. All costs incurred after determining technical feasibility and commercial viability of reserves are capitalized. Subsequent expenditures are capitalized only where they enhance the economic benefits of the asset. A gain or loss on disposal of a petroleum and natural gas interest is recognized to the extent that the net proceeds exceed or are less than the appropriate portion of the capitalized costs of the asset.

### Depletion

Petroleum and natural gas interests, including the costs of production equipment, future capital costs, estimated decommissioning liability costs, and directly attributable general and administrative costs, are depleted on the unit-of-production method based on estimated proved plus probable oil and gas reserves. Reserves are converted to equivalent units on the basis of relative energy content.

### Impairment

At each reporting date, Freehold assesses groups of assets or CGUs, for impairment whenever events or changes in circumstances indicate that the carrying value of the CGU may not be recoverable. If any such indication of impairment exists, Freehold makes an estimate of its recoverable amount. A CGU's recoverable amount is the higher of its fair value less costs of disposal (FVLCTD) and its value in use (VIU). Where the carrying amount of a CGU exceeds its recoverable amount, the CGU is considered impaired and is written down. In assessing VIU, the estimated future cash flows are adjusted for the risks specific to the CGU and are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money. FVLCTD is the amount obtainable from the sale of assets in an arm's length transaction less cost of disposal.

An assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or have decreased. If such indication exists, the recoverable amount is estimated. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the CGU's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the CGU is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depletion, had no impairment loss been recognized for the CGU in prior periods. Such a reversal is recognized in profit or loss. After such a reversal, the depletion charge is adjusted in future periods to allocate the CGU's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

## d. Decommissioning liability

Freehold measures the decommissioning liability as the present value of management's best estimate of the expenditure required to settle the liability at the reporting date using a risk-free discount rate. This estimate is recognized when a legal or constructive obligation arises and is recorded as both a short and long-term liability, with a corresponding increase in the carrying value of the petroleum and natural gas working interest asset. The capitalized amount is depleted on a unit-of-production method over the life of the reserves. At each reporting date, the passage of time and changes to estimates results in liability changes, and the amount of accretion is charged against current period income.

### e. Income tax

Income tax expense comprises current and deferred tax.

Current tax is expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

### f. Share based compensation plans

**Long-term incentive plan**

In 2017, Freehold adopted a new long-term incentive plan (LTIP) to replace the previous long-term incentive plan for the employees of Rife Resources Ltd. (Rife) through the Manager of Freehold, Rife Resources Management Ltd. (see Related Party note 9) Grants will no longer be made under the previous plan but pre-existing grants will continue until vesting and payout occurs.

Freehold's new long-term incentive plan consists of grants of performance share units (PSUs) and restricted share units (RSUs). Underlying each PSU and RSU is one notional Freehold common share. The notional Freehold common shares are adjusted whenever a dividend is paid by Freehold. Upon vesting of the RSUs the holder is entitled to an amount equal in value to the notional Freehold common shares (as adjusted for dividends paid) underlying such RSUs. The value of the notional Freehold common shares is based on the volume weighted average trading price of Freehold common shares on the TSX for the five trading days prior to the settlement date of such RSUs. Generally, one-third of the granted RSUs will vest on each of the first, second and third anniversaries of the date of grant.

For PSUs, the notional Freehold common shares and value are calculated in the same manner as the RSUs, but with the additional application of a performance multiplier. The metrics used for determining the performance multiplier (which can range from 0 to 2 times) are at the discretion of Freehold’s Board of Directors at the time of grant. Generally, all of the granted PSUs will vest on the third anniversary of the date of grant.

Since participants receive a cash payment on a fixed vesting date, a liability is determined and recognized as services are rendered based on the fair value of the total rights at each period end. The valuation incorporates the consideration of the Freehold common share price, the number of notional Freehold common shares outstanding at each period end, an estimated performance multiplier, if applicable, and an estimated forfeiture rate. Compensation expense is recognized over the vesting period.

The previous LTIP uses a combination of the value of phantom Rife shares and Freehold shares as the basis for rights, which are granted annually at the discretion of the directors of Rife and vest at the end of a three-year period. Dividends to shareholders paid by Freehold during the vesting period are assumed to be reinvested in notional rights on the dividend payment date. Since participants in the LTIP receive a cash payment on a fixed vesting date, a liability is determined and recognized as services are rendered based on the fair value of the rights at each period end. The valuation incorporates the consideration of the share price, the number of rights outstanding at each period end, an estimated performance multiplier (0.25 to 1.5 times the market value) and an estimated forfeiture rate. Compensation expense is recognized over the vesting period. Freehold is responsible for funding its proportionate share of this plan.

#### Deferred share unit plan

A deferred share unit (DSU) plan was established for the non-management directors of Freehold whereby fully-vested DSUs are granted annually. Under this plan, dividends to shareholders declared prior to redemption are assumed to be reinvested on behalf of the directors in notional share units on the dividend payment date. Compensation expense is recognized at the market value of Freehold's common shares at the time of grant or dividend, with a corresponding increase to contributed surplus. Upon redemption of the DSUs for Freehold's common shares, the amount previously recognized in contributed surplus is recorded as an increase to shareholders' capital.

### g. Net income per share

Basic net income per share is calculated using the weighted average number of shares outstanding for each period. Diluted net income per share is calculated using the weighted average number of diluted shares outstanding for each period. Diluted shares outstanding are calculated assuming that any proceeds received from options with a market value in excess of option price would be used to buy back shares at the average market price for the period.

### h. Revenue recognition

Royalty and other revenue is made up of royalty, working interest and other revenue earned during the period. Royalty and other revenue represent the sale of crude oil, natural gas, natural gas liquids and other products. Revenue is recognized when title passes from Freehold, or the operator of Freehold's properties, to its customers. Royalty and other revenue is measured at the fair value, using estimates, per the terms of various agreements. Actual results could differ as a result of using estimates and any differences are recorded in the period in which actuals are received.

### i. Financial instruments

All financial instruments, including all derivatives, are recognized on the balance sheet initially at fair value. Subsequent measurement of all financial assets and liabilities, except those measured at fair value through profit and loss and available-for-sale, are measured at amortized cost using the effective interest rate method. Available for-sale financial assets are measured at fair value with changes in fair value recognized in comprehensive income and reclassified to earnings when derecognized or impaired.

Cash and short-term investments, if any, are financial assets measured at fair value through profit or loss, and the fair values approximate their carrying value due to their short-term nature. Accounts receivable are classified as loans and receivables and are measured at amortized cost. Dividends payable, accounts payable and accrued liabilities and long-term debt are classified as other financial liabilities and are measured at amortized cost. The fair values of accounts receivable, dividends payable, accounts payable and accrued liabilities approximate their carrying value due to the short-term nature of these instruments. Freehold has not designated any financial instruments as available-for-sale, held-to-maturity or financial liabilities at fair value through profit and loss. Freehold does not have any material embedded derivatives that required separate recognition and measurement.

A three level hierarchy that reflects the significance of the inputs used in making the fair value measurements is required. Fair values of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement.

### j. Recent pronouncements

In May 2014, the IASB issued IFRS 15 Revenue from Contracts with Customers, which replaces IAS 11 Construction Contracts, IAS 18 Revenue, and other revenue related interpretations. The standard establishes a single revenue recognition framework that applies to contracts with customers. The effective date for adopting IFRS 15 in its entirety is January 1, 2018. Freehold has completed its review of various revenue streams and underlying contracts with customers and concluded that the adoption of IFRS 15 will not have a material effect on its consolidated financial statements. Commencing in the first quarter of 2018, Freehold will expand the disclosures in the notes to its consolidated financial statements as prescribed by IFRS 15. The new disclosure will include disaggregated revenue streams similar to what has been historically disclosed in Freehold’s Management Discussion and Analysis.

In July 2014, the IASB completed a three-phase project to replace IAS 39 Financial Instruments: Recognition and Measurement with IFRS 9 Financial Instruments. The first two completed phases replaced the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. The third phase describes a new hedge accounting model. Presently and historically, Freehold has not entered into any transactions in which hedge accounting could be applied. Freehold has concluded the standard will not have a material impact on its consolidated financial statements aside from changes to classification of financial assets. The effective date for adopting IFRS 9 in its entirety is January 1, 2018.

In January, 2016, the IASB issued IFRS 16 Leases, which replaces IAS 17 Leases. The standard establishes a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. Other areas of the lease accounting model have been impacted, including the definition of a lease. Transitional provisions have been provided. The effective date for adopting IFRS 16 in its entirety is January 1, 2019. Freehold’s assessment of the lease standard is ongoing and the impact, if any, on the consolidated financial statements and additional disclosure requirements is yet to be fully determined.

## 3. Assets Held For Sale

In December 2017, Freehold signed an agreement to sell its Pembina Cardium Unit No. 9 working interest property in exchange for estimated proceeds of $8.2 million (including adjustments) and an acquisition of a new 4% gross overriding royalty (GORR) on the same property. At December 31, 2017, this working interest property was classified as assets held for sale as it was highly probable that its carrying value would be received through a sales transaction rather than continued use. At December 31, 2017, this working interest asset was recorded on the consolidated financial statements at the lower of carrying value and management's best estimate of its fair value less costs to sell, resulting in Freehold recording an impairment of $6.3 million. Freehold reclassified its new recoverable estimated net book value of $13.8 million from its Other Working Interest CGU in petroleum and natural gas interests to assets held for sale. In addition, Freehold reclassified its proportionate share of decommissioning liabilities of $3.7 million to liabilities related to assets held for sale. In February 2018 Freehold closed the transaction.

## 4. Exploration and Evaluation Assets

| ($000s) | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Balance, beginning of year | 64,019 | 49,479 |
| Acquisitions (note 5) | 15,900 | 17,980 |
| Transfers to petroleum and natural gas interests (note 5) | (3,876) | (3,440) |
| Working interest dispositions | (267) | - |
| Balance, end of year | 75,776 | 64,019 |

There were no indicators of impairment or impairment reversal for the year ended December 31, 2017 or December 31, 2016. As a result no impairment or impairment reversal testing was conducted.

## 5. Petroleum and Natural Gas Interests

| ($000s) | December 31, 2017 | December 31, 2016 |
|---|---|---|
| **Cost** | | |
| Balance, beginning of year | 1,420,836 | 1,271,382 |
| Acquisitions | 70,843 | 144,610 |
| Capital expenditures | 4,864 | 5,218 |
| Capitalized portion of long term incentive plan | 246 | 167 |
| Transfers from exploration and evaluation assets (note 4) | 3,876 | 3,440 |
| Decommissioning liability additions and revisions (note 7) | 3,225 | (3,981) |
| Transfer to assets held for sale (note 3) | (19,534) | - |
| Working interest dispositions | (97,073) | - |
| Balance, end of year | 1,387,283 | 1,420,836 |
| **Accumulated depletion and depreciation** | | |
| Balance, beginning of year | (528,716) | (424,557) |
| Depletion and depreciation | (108,227) | (104,159) |
| Impairment | (10,609) | - |
| Transfer to assets held for sale (note 3) | 5,724 | - |
| Accumulated depletion and depreciation of working interest dispositions | 73,466 | - |
| Balance, end of year | (568,362) | (528,716) |
| **Net book value, end of year** | 818,921 | 892,120 |

The depletion calculation included $7.3 million (2016 - $13.8 million) for estimated future development costs associated with proved plus probable undeveloped reserves.

For the year ended December 31, 2017, Freehold capitalized $1.5 million (2016 - $1.5 million) of administrative costs and capitalized $0.2 million (2016 – $0.2 million) of LTIP costs directly related to development activities.

### Acquisitions

For the year ended December 31, 2017, Freehold closed an acquisition of various gross overriding royalties and mineral title lands in the greater Dodsland area of Saskatchewan for $33.7 million (including adjustments) and an acquisition of a new 2% gross overriding royalty in the Cardium in the greater Pembina area of Alberta for $52.3 million (including adjustments) and the assignment by Freehold of certain minor working interest properties. This acquisition included $15.9 million of undeveloped land classified as an exploration and evaluation asset. In addition, for the year ended December 31, 2017, Freehold had minor acquisitions and adjustments on previous acquisitions resulting in additions of $0.7 million to petroleum and natural gas interests.

For year ended December 31, 2016, Freehold acquired an extensive suite of royalty production and lands for $161.8 million (including adjustments) which included $17.9 million of undeveloped land classified as an exploration and evaluation asset. In addition for year ended December 31, 2016, Freehold had minor acquisition expenditures of $0.8 million.

### Working Interest Dispositions

In April 2017, Freehold closed the sale of working interest properties in its Southeast Saskatchewan Working Interest CGU for proceeds of $29.0 million (including adjustments). In conjunction with these transactions, Freehold recognized a gain on working interest dispositions of $14.9 million. The gain was based on $29.1 million of proceeds received, minor adjustments of $0.1 million, the removal of assets held for sale of $18.9 million and the removal of liabilities related to assets held for sale of $4.8 million. At March 31, 2017, based on the anticipated sale proceeds, Freehold reviewed the carrying value of the Southeast Saskatchewan Working Interest CGU for any reversal of impairment, as this CGU had a previous impairment charge. The recoverable amount was estimated using a fair value less cost to sell calculation based on the estimated sales price. As a result, there was an impairment reversal of $5.6 million recognized at the time of disposition, representing the maximum amount of impairment reversal able to be taken, made up of the original $8.0 million impairment estimate recorded in 2015 net of $2.4 million depletion calculated as if the impairment never occurred.

In addition, for the year ended December 31, 2017, Freehold sold additional minor working interest properties for $3.4 million (including adjustments).

### Year-end Impairment

At December 31, 2017, Freehold tested the remaining working interest properties in its Other Working Interest CGU for impairment due to existing market conditions. Freehold estimated the recoverable amount as the value in use based on discounted future net cash flows of proved and probable reserves using forecast prices and costs, discounted between 15% and 25% (pre-tax). In determining the discount rate, Freehold considered the resource composition of the remaining assets including reserve type, operating expense and future development plans. The estimated recoverable amount was based on Freehold's December 31, 2017 external reserve report. Management recognizes that all assumptions and estimates affecting the value are subject to a high degree of uncertainty. Freehold recognized a non-cash impairment charge of $9.9 million as the carrying value exceeded the estimated value in use. The Other Working Interest CGU contains all of Freehold's working interest properties widespread across Western Canada. The estimated recoverable amount of this CGU at December 31, 2017 is $14.7 million.

As future commodity prices continue to fluctuate, additional impairment charges or recoveries could be recorded in future periods. The value in use estimates are categorized as Level 3 according to the IFRS 13 fair value hierarchy.

The following table summarizes key benchmarks used in the impairment estimate.

| | WTI | WCS | AECO | Exchange rate |
|---|---|---|---|---|
| | US$/bbl | Cdn$/bbl | Cdn$/Mcf | Cdn$/US$ |
| 2018 | 55.00 | 51.05 | 2.85 | 0.79 |
| 2019 | 65.00 | 59.61 | 3.11 | 0.82 |
| 2020 | 70.00 | 64.94 | 3.65 | 0.85 |
| 2021 | 73.00 | 68.43 | 3.80 | 0.85 |
| 2022 | 74.46 | 69.80 | 3.95 | 0.85 |
| 2023 | 75.95 | 71.20 | 4.05 | 0.85 |
| Average annual increase, thereafter | 2.0% | 2.0% | 2.0% | - |

The following table summarizes impairments and impairment reversal for 2017:

| ($000s) | Cash Generating Unit | Impairment (reversal) |
|---|---|---|
| Southeast Saskatchewan working interest properties | Southeast Saskatchewan Working Interest | (5,625) |
| Pembina Cardium Unit No. 9 (note 3) | Other Working Interest | 6,323 |
| Year-end impairment | Other Working Interest | 9,911 |
| Total | | 10,609 |

There were no indicators of impairment or impairment reversal for the year ended December 31, 2016. As a result no impairment or impairment reversal testing was conducted.

## 6. Long-Term Debt

At December 31, 2017 Freehold had a $165 million extendible revolving term credit facility with a syndicate of four Canadian chartered banks, on which $90 million was drawn. In addition, Freehold has available a $15 million extendible revolving operating facility.

The facilities are secured with $400 million demand debentures over most of Freehold's petroleum and natural gas assets but do not contain any financial covenants. The lenders at any time can request a redetermination of the borrowing base, which may require a repayment to the lenders within 90 days of receiving notice, of an amount that the indebtedness is in excess of the redetermined borrowing base. Freehold's borrowing base is dependent on the lenders review and interpretation of Freehold's reserves and future commodity prices. During the second quarter 2017 the annual review was completed. The next renewal will occur by May 31, 2018. In the event that the lenders do not consent to an extension, the revolving credit facility would revert to a one-year, non-revolving term facility with repayment due at the termination date.

Borrowings under the facilities bear interest at the bank's prime lending rate, bankers' acceptance or LIBOR rates plus applicable margins and standby fees. At December 31, 2017 and December 31, 2016 the fair values of the long-term debt approximated its carrying value, as the long-term debt carries interest at prevailing market rates. In 2017, the average effective interest rate on advances under Freehold's credit facilities was 2.9% (2016 – 2.9%).

## 7. Decommissioning Liability

Freehold has no decommissioning liability on its royalty interest properties. Freehold's decommissioning liability results from its responsibility to abandon and reclaim its net share of all working interest properties. The undiscounted value of

Freehold's total decommissioning liability is estimated to be $19.3 million (2016 – $36.3 million). Payments to settle the obligations are expected to occur over the next 52 years, with the majority being settled within 10 years. At December 31, 2017, a risk-free rate of 2.2% (2016 – 2.3%) and an inflation rate of 2.0% (2016 – 2.0%) were used to calculate the fair value.

| ($000s) | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Balance, beginning of year | 23,705 | 27,635 |
| Liabilities incurred | 84 | 45 |
| Liabilities settled | (1,865) | (492) |
| Revision in estimates [(1)] | 3,141 | (4,026) |
| Accretion expense | 459 | 543 |
| Liabilities disposed (note 5) | (6,319) | - |
| Transfers to liabilities related to assets held for sale (note 3) | (3,710) | - |
| Balance, end of year | 15,495 | 23,705 |
| Current portion of liability | 1,444 | - |
| Long-term portion of liability | 14,051 | 23,705 |

(1) For the year ended December 31, 2017 the revision in estimates increase was primarily a result of the change in estimated abandonment costs and years.

## 8. Shareholders' Capital

Freehold has authorized an unlimited number of common shares, without stated par value. Freehold has authorized 10,000,000 preferred shares, without stated par value, of which none have been issued.

**Shares Issued and Outstanding**

| | December 31, 2017 | | December 31, 2016 | |
|---|---|---|---|---|
| | Shares | Amount ($000s) | Shares | Amount ($000s) |
| Balance, beginning of year | 117,918,274 | 1,263,796 | 98,940,152 | 1,050,494 |
| Issued for dividend reinvestment plan | - | - | 488,060 | 4,997 |
| Issued for payment of management fee | 220,000 | 3,043 | 287,648 | 3,543 |
| Issued for deferred share unit plan redemption | 44,393 | 752 | 59,198 | 1,066 |
| Cancelled | - | - | (17,684) | (214) |
| Issued for equity offering | - | - | 18,160,900 | 209,759 |
| Issue costs, net of tax effect | - | - | - | (5,849) |
| Balance, end of year | 118,182,667 | 1,267,591 | 117,918,274 | 1,263,796 |

On May 25, 2016, Freehold closed a bought deal equity offering, issuing 16,428,900 common shares and a private equity offering with CN Pension Trust Funds (see note 9) issuing 1,732,000 common shares, both at a price of $11.55 per share for gross proceeds of $209.8 million. The issue costs including the underwriter fees were $8.0 million ($5.8 million net of a tax effect).

On November 30, 2016, the rights of holders of trust units of Freehold Royalty Trust not deposited on or prior to this date have been terminated. Therefore, for the year ended December 31, 2016, Freehold cancelled 17,684 common shares and received $0.1 million for the return of related unclaimed accumulated dividends.

At December 31, 2017, a balance of 1,987,307 shares was reserved for the dividend reinvestment plan (DRIP), 458,467 shares for the management fee (note 9) and 467,344 shares for the deferred share unit plan (note 10).

For the year ended December 31, 2016, deferred share units were excluded from the calculation of diluted net loss per share as their effect was anti-dilutive.

## 9. Related Party Transactions

Freehold does not have any employees. Rife Resources Management Ltd. (the Manager) is the manager of Freehold. The Manager is a wholly-owned subsidiary of Rife Resources Ltd. (Rife), and two of Rife's directors are also directors of Freehold. Rife is 100% owned by the CN Pension Trust Funds (the pension funds for the employees of the Canadian National Railway Company), which in turn is a shareholder of Freehold. The Manager recovers its general and administrative costs and a portion of its long-term incentive plan costs, and receives a quarterly management fee paid in shares. Canpar Holdings Ltd. (Canpar) is also managed by Rife and owned 100% by the CN Pension Trust Funds, and two of Canpar's directors are also directors of Freehold.

### (a) Rife Resources Management Ltd.

The Manager provides certain services for a fee based on a specified number of shares per quarter, pursuant to the amended and restated Management Agreement. The Management Agreement capped the management fee at 55,000 shares per quarter for 2017 and the number of shares to be issued per quarter as payment of the management fee decreases to a level of 5,500 shares per quarter by 2023. For the year ended December 31, 2017, Freehold issued 220,000 shares (2016 – 287,648) as payment of the management fee to the Manager pursuant to the Management Agreement. For the year ended December 31, 2017, the ascribed value of $3.0 million (2016 – $3.5 million) was based on the closing price of the shares on the last trading day of each quarter.

For the year ended December 31, 2017, the Manager charged $9.5 million in general and administrative costs (2016 – $9.0 million). At December 31, 2017, there was $0.6 million (2016 – $0.9 million) in accounts payable and accrued liabilities relating to these costs.

### (b) Rife Resources Ltd.

Freehold maintains ownership interests in certain oil and gas properties operated by Rife. A portion of net operating revenues and capital expenditures represent joint operations amounts from Rife. At December 31, 2017, there was $nil (2016 - $0.1 million) in accounts receivable related to these transactions. At December 31, 2017, there was $0.1 million (2016 - $nil) in accounts payable and accrued liabilities relating to these transactions.

In addition, Freehold receives royalties from Rife pursuant to various royalty agreements. For the year ended December 31, 2017, Freehold received royalties of approximately $0.9 million (2016 – $0.9 million). At December 31, 2017, there was $0.1 million (2016 - $0.1 million) in accounts receivable relating to these transactions.

### (c) Canpar Holdings Ltd.

Freehold and Canpar share mineral title ownership rights in a substantial land base in western Canada. Generally, Canpar owns mineral rights that were below the deepest producing formation at the time that Freehold was created, and Freehold holds the balance of the mineral rights. Given the nature of the mineral rights, which are dependent upon hydrocarbon pool formation classification as well as third party drilling data which is subject to change and revision, significant uncertainty can exist with respect to the royalty ownership of wells drilled and completed on lands where both Freehold and Canpar hold the mineral rights.

At December 31, 2017, there was $nil (2016 – $nil) in accounts receivable relating to transactions with Canpar. At December 31, 2017, there was $0.1 million (2016 – $nil) in accounts payable and accrued liabilities relating to transactions with Canpar.

### (d) CN Pension Trust Funds

Concurrent with the closing of the bought deal public equity offering completed by Freehold on May 25, 2016, CN Pension Trust Funds invested approximately $20 million through the purchase of 1,732,000 common shares on a non-brokered private placement basis. The price paid per common share by CN Pension Trust Funds pursuant to the private placement was the same price paid per common share by purchasers pursuant to the bought deal public equity offering.

All amounts owing to/from the Manager, Rife, and Canpar are unsecured, non-interest bearing and due on demand. All transactions were in the normal course of operations and were measured at the amount of consideration established and agreed to by both parties.

Expenses relating to compensation for key management personnel, considered to be Freehold's Board of Directors and Senior Management, are as follows:

| ($000s) | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Short-term benefits (including employee wages and directors fees) | 1,143 | 966 |
| Share based compensation (note 10a and 10b) | 705 | 640 |
| Total | 1,848 | 1,606 |

## 10. Share Based Compensation

### a. Long-term incentive plan

Freehold funds its proportionate share of the costs associated with the LTIPs for employees of Rife through the Manager, as described in note 2f. The share based compensation expense was based on the consideration of the share price, the number of share based awards outstanding at each period end, an estimated performance multiplier and an estimated forfeiture rate. For 2017 PSU grants, the performance multiplier of 0 to 2 times is based 50% on an absolute total shareholder return and 50% on a relative total shareholder return over a three year performance period. The 2015 LTIP grants valued at $0.1 million were paid out in 2017. The total expensed for the year ended December 31, 2017 was $1.2 million (2016 – $0.8 million). For the year ended December 31, 2017, Freehold capitalized $0.2 million (2016 – $0.2 million) of LTIP costs directly related to development activities.

The following table reconciles the change in total accrued share based incentive compensation:

| ($000s) | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Balance, beginning of year | 1,065 | 257 |
| Increase in liability | 1,446 | 928 |
| Cash payout | (138) | (120) |
| Balance, end of year | 2,373 | 1,065 |
| Current portion of liability | 399 | 133 |
| Long-term portion of liability | 1,974 | 932 |

The following table reconciles the incentive plan activity:

**Share Based Awards**

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Balance, beginning of year (1) | 207,250 | 134,891 |
| Issued | 90,026 | 105,735 |
| Dividends reinvested (1) | 10,571 | 10,774 |
| Cash payout | (38,298) | (44,150) |
| Balance, end of year | 269,549 | 207,250 |

(1) Balance as at December 31, 2016 has been adjusted for revised estimates.

### b. Deferred share unit plan

Freehold has a deferred share unit (DSU) plan for non-management directors as described in note 2f. As at December 31, 2017, there were 117,429 DSUs outstanding (2016 – 148,499), which are redeemable for an equal number of shares any time after the director's retirement. On January 1, 2017, Freehold's Board of Directors granted a total of 27,521 DSUs to eligible directors as part of their annual compensation. Each eligible director received 4,234 DSUs and the Chair of the Board received 6,351 DSUs. In 2016, Freehold's Board of Directors granted a total of 46,663 DSUs to eligible directors as part of their annual compensation. Each eligible director received 5,525 DSUs and the Chair of the Board received 8,287 DSUs.

For the year ended December 31, 2017, 63,419 DSUs were redeemed resulting in the issuance of 44,393 shares from treasury. In payment of withholding tax, 19,026 DSUs were canceled and the cash value of $0.3 million was remitted to the Canada Revenue Agency. For the year ended December 31, 2016, 84,567 DSUs were redeemed resulting in the issuance of 59,198 shares from treasury. In payment of withholding tax, 25,369 DSUs were cancelled and the cash value of $0.3 million was remitted to Canada Revenue Agency.

**Deferred Share Units**

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Balance, beginning of year | 148,499 | 177,012 |
| Annual grants | 27,521 | 46,663 |
| Additional resulting from dividends | 4,828 | 9,391 |
| Redeemed | (63,419) | (84,567) |
| Balance, end of year | 117,429 | 148,499 |

For the year ended December 31, 2017, Freehold expensed $0.4 million (2016 - $0.4 million) of share based compensation with a corresponding offset to contributed surplus.

## 11. Income Taxes

Freehold uses the balance sheet method of accounting for income taxes, as described in note 2e. The provision for taxes in the financial statements differs from the result which would have been obtained by applying the combined federal and provincial effective tax rate to Freehold's income before taxes. This difference is reconciled as follows:

| ($000s, except as noted) | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Income (loss) before taxes | 17,032 | (14,260) |
| Combined federal and provincial tax rate | 27.0% | 27.0% |
| Computed expected income tax expense (recovery) | 4,599 | (3,850) |
| Increase in income tax resulting from: | | |
| True up of tax pools | 5 | 460 |
| Deferred share unit plan redemption | 195 | 288 |
| Miscellaneous items | 15 | 5 |
| Total income taxes | 4,814 | (3,097) |

The components of deferred income tax are as follows:

| ($000s) | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Deferred income tax assets: | | |
| Non-capital losses | 44,866 | 47,250 |
| Decommissioning liability | 5,185 | 6,400 |
| Share issue expense | 3,266 | 4,838 |
| Deferred income tax liabilities: | | |
| Petroleum and natural gas interests | (32,880) | (33,074) |
| Other | 1,104 | 941 |
| Net deferred income tax asset | 21,541 | 26,355 |

As at December 31, 2017, Freehold had approximately $168 million (2016 - $176 million) of carry-forward non-capital tax losses and approximately $799 million (2016 - $852 million) of tax pools that would be available to offset against future taxable profit. The carry-forward losses will expire between the years 2030 and 2036. Deferred income tax assets are recognized to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and the carry-forward of unused tax losses can be utilized.

The continuity of deferred income tax is as follows:

| ($000s) | Balance December 31 2016 | Recognized in Profit or Loss | Recognized in Equity | Balance December 31 2017 |
|---|---|---|---|---|
| Non-capital losses | 47,250 | (2,384) | - | 44,866 |
| Decommissioning liability | 6,400 | (1,215) | - | 5,185 |
| Share issue expense | 4,838 | (1,572) | - | 3,266 |
| Petroleum and natural gas interests | (33,074) | 194 | - | (32,880) |
| Other | 941 | 163 | - | 1,104 |
| Total | 26,355 | (4,814) | - | 21,541 |

Freehold's deferred tax liability relates to its assets having a higher carrying value relative to the associated tax value. Freehold's deferred tax asset primarily relates to the non-capital losses. When combined there is an overall net deferred tax asset.

## 12. Capital Management

Freehold is a publicly traded dividend-paying corporation incorporated under the laws of the Province of Alberta. Its primary focus is acquiring and managing oil and gas royalties. Freehold receives revenue from oil and gas properties as reserves are produced, which is paid to shareholders on a regular basis over the economic life of the properties. Freehold's objective for managing capital is to maximize long-term shareholder value by distributing to shareholders any cash that is not required for financing operations or capital investment growth opportunities that may offer shareholders better value.

Freehold defines capital as long-term debt, shareholders' equity and working capital based on the consolidated financial statements. Freehold's capital structure is managed by taking into account operating activities, debt levels, debt covenants, capital expenditures, DRIP participation, dividend levels and taxes, among others. In addition, changes in economic conditions, commodity prices and the risk characteristics of Freehold's assets are considered. Freehold has a declining asset base, therefore ongoing development activities and acquisitions are necessary to replace production and add additional reserves. From time to time, Freehold may issue shares or adjust capital spending to manage current and projected debt levels.

Freehold retains working capital primarily to fund capital expenditures or acquisitions, pay dividends and reduce bank indebtedness. Historically, Freehold has chosen to issue its DRIP out of treasury, which increases its flexibility with the use of working capital. Effective with the August 31, 2016 dividend the Board approved the suspension of the DRIP pending further notice.

Management of Freehold's capital structure is facilitated through its financial and operating forecasting processes. The forecast of Freehold's future cash flows is based on estimates of production, commodity prices, forecast capital, royalty expenses, operating expenditures, taxes and other investing and financing activities. The forecast is regularly updated based on new commodity prices and other changes that Freehold views as critical in the current environment. Selected forecast information is frequently provided to and approved by the Board of Directors.

Freehold is bound by non-financial covenants on its credit facilities. The covenants are monitored as part of management's internal review to ensure compliance with requirements. Under the credit facilities, Freehold is restricted from paying dividends if it is or would be in default under the credit facilities or if borrowings thereunder exceed the borrowing base. As at December 31, 2017, Freehold was in compliance with all such covenants.

### Capitalization

| ($000s, except as noted) | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Shareholders' equity | 831,592 | 884,696 |
| Long term debt | 90,000 | 84,000 |
| Working capital | (21,379) | (10,839) |
| Net debt (1) | 68,621 | 73,161 |
| | | |
| Cash provided by operating activities for last 12 months | 119,267 | 93,133 |
| Change in non-cash operating working capital | 4,521 | 1,078 |
| Trailing 12 months funds from operations | 123,788 | 94,211 |
| | | |
| Net debt to trailing 12 month funds from operations (times) | 0.6 | 0.8 |

(1) Net debt as presented does not have any standardized meaning prescribed by IFRS and therefore may not be comparable to a similar measure of other entities.

## 13. Financial Instrument Risk Management

Freehold has exposure to credit, liquidity and market risks from its use of financial instruments. Management employs the following strategies to mitigate these risks.

### a. Credit risk

Credit risk is the risk of financial loss to Freehold if a customer or counterparty to a financial instrument fails to meet its contractual obligations and arises principally from Freehold’s receivables. A large part of accounts receivable is with oil and gas industry operators, either as joint venture partners or as payors of various royalty agreements. These agreements provide mechanisms to ensure that Freehold's interests are protected. There are also systems and processes in place to identify any unpaid or incorrect revenues. Freehold’s diversified revenue stream limits the size of any one property or industry operator with respect to total receivables. Freehold also has processes and systems in place to monitor the financial capabilities of its counterparties. Many agreements allow Freehold to take the commodity in-kind and sell directly to a purchaser rather than have Freehold’s commodity flow through the operator or the royalty payor.

Freehold maintains a dedicated compliance function, with a comprehensive auditing program, to ensure that the terms of the various agreements are followed, including that royalties are paid correctly on production from Freehold’s lands in accordance with the prices obtained by the royalty payor and that unwarranted or excessive deductions are not being taken. Freehold also audits its working interest properties to ensure that capital costs, operating expenses and production volumes are properly allocated.

The carrying amounts of accounts receivable and cash represent Freehold’s maximum credit exposure. Freehold did not have an allowance for doubtful accounts as at December 31, 2017 or 2016, and did not provide for any doubtful accounts and was not required to write off any significant receivables during the years ended December 31, 2017 or 2016. Freehold considers all material amounts greater than three months to be past due. Due to the nature of Freehold’s royalty income assets, there are amounts over three months which require significant time and effort to collect. Estimates of amounts owed for various time periods are as follows:

| ($000s) | Less than 3 months | 4-12 months | over 1 year | Total |
|---|---|---|---|---|
| Accounts receivable | 23,841 | 1,351 | 760 | 25,952 |

Freehold markets approximately 77% of its production along with the operator or royalty payor under the terms of a diverse number of agreements. Freehold takes a portion of its production in kind (approximately 23%) and sells to three primary purchasers.

### b. Liquidity risk

Liquidity risk is the risk that Freehold will not be able to meet financial obligations as they come due. Management maintains a conservative approach to debt management that aims to provide maximum financial flexibility with respect to acquisitions and development expenditures, while maintaining stable dividend payments. At December 31, 2017, there was $90 million of available capacity under the credit facilities. As circumstances warrant, management allocates a portion of funds from operations to debt repayment. Management prepares annual capital expenditure and operating budgets, which are regularly monitored and updated. In addition, dividend levels are monitored and adjusted as necessary to levels that are supported by our funds from operations.

Freehold's non-derivative financial liabilities include its dividends payable, accounts payable and accrued liabilities, share based compensation payable, current portion of decommissioning liability and long-term debt. Freehold has no derivative financial liabilities. The following table outlines cash flows associated with the contractual maturities of Freeholds non-derivative financial liabilities as at December 31, 2017:

| ($000s) | Less than 1 Year | 2-3 Years | Total |
|---|---|---|---|
| Dividends payable | 5,908 | - | 5,908 |
| Accounts payable and accrued liabilities | 7,206 | - | 7,206 |
| Current portion of share based compensation payable | 399 | 1,974 | 2,373 |
| Current portion of decommissioning liability | 1,444 | - | 1,444 |
| Long-term debt | - | 90,000 | 90,000 |
| Total | 14,957 | 91,974 | 106,931 |

### c. Market risk

Market risk is the risk that changes in market prices, such as foreign currency exchange rates, commodity prices and interest rates, will affect net income or the value of financial instruments. The Board reviews the potential use of derivative contracts on a quarterly basis. For short-term investments, if any, Freehold selects counterparties based on strong credit ratings and monitors all investments to ensure a stable return.

#### Foreign currency exchange rate risk

Freehold does not sell or transact in any foreign currency; however, the underlying market prices in Canada for oil and natural gas are influenced by changes in the exchange rate between the Canadian and U.S. dollar. During the years ended December 31, 2017 and 2016, Freehold had no foreign exchange related derivative contracts in place. Assuming all other variables held constant, a $0.01 change (plus or minus) in the U.S./Canadian dollar exchange rate for the year ended December 31, 2017, would have resulted in a corresponding change to income before taxes of approximately $1.6 million (2016 - $1.4 million).

#### Commodity price risk

Commodity price risk is the risk that the fair value of future cash flows will fluctuate with changes in commodity prices. Commodity prices for oil and natural gas are influenced by the relationship between the Canadian and U.S. dollar as well as macroeconomic events that dictate the levels of supply and demand. During the years ended December 31, 2017 and 2016, Freehold had no commodity price related derivative contracts in place. Assuming all other variables held constant, a US$1.00 change (plus or minus) in the West Texas Intermediate crude oil price for the year ended December 31, 2017, would have resulted in a corresponding change to income before taxes of approximately $2.4 million (2016 - $2.4 million). A $0.25 change (plus or minus) in the AECO natural gas price would have resulted in a corresponding change to income before taxes of approximately $2.3 million (2016 - $2.4 million).

#### Interest rate risk

Freehold is exposed to interest rate risk on outstanding bank debt, which has a floating interest rate, and fluctuations in interest rates would impact future cash flows. Assuming all other variables held constant, a 1% change (plus or minus) in the interest rate for the year ended December 31, 2017 would have resulted in a corresponding change to income before taxes of approximately $0.7 million (2016 - $1.2 million).

## 14. Supplemental Disclosure

### a. Statements of income and comprehensive income presentation

Freehold's consolidated statements of income and comprehensive income are prepared by nature of expense.

### b. Supplemental cash flow disclosure

**Changes in Non-Cash Working Capital Balance**

| ($000s) | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Accounts receivable | (1,888) | (3,018) |
| Current taxes receivable | - | 73 |
| Accounts payable and accrued liabilities | (2,013) | (607) |
| | (3,901) | (3,552) |
| | | |
| Operating | (4,521) | (1,078) |
| Investing | 620 | (2,474) |
| | (3,901) | (3,552) |

**Cash Expenses**

| ($000s) | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Interest | 2,705 | 4,343 |
| Taxes paid (received) | - | (73) |

### c. Royalty and other revenue

| ($000s) | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Royalty interest revenue (1) | 133,822 | 103,464 |
| Working interest revenue (2) | 18,072 | 26,504 |
| Total royalty and other revenue | 151,894 | 129,968 |

(1) Royalty interest revenue includes potash, sulphur, bonus consideration and lease rentals.
(2) Working interest revenue includes processing fees, interest and other.

### d. Net debt

| ($000s) | December 31, 2017 | December 31, 2016 |
|---|---|---|
| Long-term debt | 90,000 | 84,000 |
| Working capital | (21,379) | (10,839) |
| Net debt (1) | 68,621 | 73,161 |

(1) Net debt as presented does not have any standardized meaning prescribed by IFRS and therefore may not be comparable to a similar measure of other entities.

## 15. Other Loss

In May 2009, a statement of claim was filed against Freehold for $9 million. The claim involved disputed land interests and royalty obligations. During the year ended December 31, 2016 Freehold settled the claim with a $0.9 million payment and removed $0.2 million of associated accounts receivable, recognizing a total loss of $1.1 million.

## 16. Subsequent Events

On February 28, 2018, Freehold closed a $7.0 million royalty acquisition in the East Shale Duvernay Basin of Alberta. In addition, on March 7, 2018, Freehold closed an acquisition of two low decline light oil royalties on the Weyburn Unit and Mitsue Gilwood Sand Unit #1 in Saskatchewan for $24.0 million (before adjustments) and the assignment of certain minor working interest assets. Both transactions were funded through Freehold's existing credit facilities.

## TEN-YEAR REVIEW
(UNAUDITED)

| | 2017 | 2016 | 2015 | 2014 | 2013 | 2012 | 2011 | 2010 | 2009 | 2008 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Financial ($millions, except as noted)[1]** | | | | | | | | | | |
| Royalty and other revenue | 151.9 | 130.0 | 135.7 | 199.9 | 181.6 | 168.1 | 157.9 | 138.2 | 120.0 | 204.1 |
| Net income (loss)[1] | 12.2 | (11.2) | (4.1) | 66.4 | 57.9 | 46.3 | 55.3 | 49.3 | 31.7 | 110.0 |
| Per share ($)[2] | 0.10 | (0.10) | (0.05) | 0.94 | 0.86 | 0.71 | 0.92 | 0.85 | 0.63 | 2.23 |
| Funds from operations | 123.8 | 94.2 | 103.8 | 138.4 | 119.4 | 103.9 | 128.2 | 107.0 | 95.1 | 171.3 |
| Per share ($)[2] | 1.05 | 0.85 | 1.15 | 1.95 | 1.79 | 1.60 | 2.14 | 1.83 | 1.90 | 3.47 |
| Dividends declared | 68.5 | 59.5 | 90.1 | 119.8 | 112.5 | 109.6 | 101.0 | 98.1 | 70.5 | 143.7 |
| Per share ($)[2] [3] | 0.58 | 0.54 | 1.00 | 1.68 | 1.68 | 1.68 | 1.68 | 1.68 | 1.40 | 2.91 |
| Acquisitions | 86.7 | 162.6 | 411.4 | 248.3 | 10.1 | 60.9 | 7.5 | 38.6 | 9.5 | 7.7 |
| Capital expenditures | 4.9 | 5.2 | 22.3 | 33.7 | 29.3 | 36.7 | 25.6 | 18.1 | 15.5 | 13.0 |
| Working interest dispositions | 32.4 | - | - | - | - | - | - | - | - | - |
| Long-term debt | 90.0 | 84.0 | 152.0 | 139.0 | 49.0 | 18.0 | 48.0 | 65.0 | 45.0 | 140.0 |
| **Operating** | | | | | | | | | | |
| Production (boe/d) | 12,350 | 12,219 | 10,945 | 9,180 | 8,913 | 8,850 | 7,476 | 7,615 | 7,302 | 7,804 |
| Royalty Interest (%) | 89 | 81 | 76 | 74 | 70 | 71 | 75 | 73 | 70 | 71 |
| Oil and NGL (%) | 55 | 58 | 62 | 63 | 64 | 64 | 63 | 62 | 64 | 63 |
| Land (gross acres, millions) | 5.9 | 6.1 | 3.7 | 3.2 | 3.1 | 3.0 | 2.7 | 2.8 | 2.4 | 2.4 |
| Net reserves (Mmboe)[4] | 35.3 | 38.3 | 36.1 | 29.7 | 23.1 | 24.4 | 22.2 | 23.6 | 24.1 | 25.4 |
| Reserve life index (years) | 9.6 | 10.1 | 9.9 | 9.0 | 8.5 | 8.5 | 9.1 | 9.5 | 9.7 | 9.8 |
| **Share Data** | | | | | | | | | | |
| High ($) | 16.41 | 15.16 | 20.62 | 28.15 | 24.88 | 22.45 | 23.28 | 21.14 | 17.00 | 24.40 |
| Low ($) | 11.96 | 8.29 | 8.73 | 17.02 | 21.00 | 17.25 | 14.51 | 15.08 | 6.87 | 9.15 |
| Close ($) | 14.05 | 14.17 | 10.86 | 19.12 | 22.11 | 22.40 | 19.41 | 20.49 | 15.09 | 10.49 |
| Volume (millions) | 58.4 | 79.6 | 75.3 | 43.6 | 25.8 | 28.6 | 28.1 | 25.8 | 30.0 | 36.5 |
| Outstanding (millions) | | | | | | | | | | |
| At period end | 118.2 | 117.9 | 98.9 | 74.9 | 67.7 | 66.3 | 61.1 | 59.2 | 57.5 | 49.5 |
| Weighted average | 118.0 | 110.4 | 90.5 | 71.0 | 66.9 | 64.9 | 60.0 | 58.3 | 50.0 | 49.4 |

(1) Freehold's IFRS transition date was January 1, 2010 and reflects adjustments due to IFRS. Comparative information for 2008-2009 has not been restated.

(2) Prior to conversion to a corporation on December 31, 2010, Freehold had trust units outstanding instead of shares.

(3) Based on the number of shares issued and outstanding at each record date.

(4) Net proved plus probable reserves.

# CORPORATE INFORMATION

## Board of Directors

**Marvin F. Romanow**
Chair of the Board

**Gary R. Bugeaud** (1)(2)
Corporate Director

**Peter T. Harrison**
Manager, Oil and Gas Investments
CN Investment Division

**J. Douglas Kay** (2)(3)
Corporate Director

**Arthur N. Korpach** (1)(2)
Corporate Director

**Susan M. MacKenzie** (2)(3)
Corporate Director

**Thomas J. Mullane**
President and Chief Executive Officer
Rife Resources Ltd.

**Aidan M. Walsh** (1)(3)
Chief Executive Officer
Baccalieu Energy Inc.

(1) Audit Committee
(2) Governance, Nominating and Compensation Committee
(3) Reserves Committee

## Officers

**Marvin F. Romanow**
Chair of the Board

**Thomas J. Mullane**
President and Chief Executive Officer

**Darren G. Gunderson**
Vice-President, Finance and Chief Financial Officer

**Robert E. Lamond**
Vice-President, Exploration

**David M. Spyker**
Vice-President, Production

**Michael J. Stone**
Vice-President, Land

**Michael J. Mogan**
Controller

**Karen C. Taylor**
Corporate Secretary

## Head Office

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**w.** freeholdroyalties.com

## The Manager

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## Investor Relations

**Matt J. Donohue**
Manager, Investor Relations
**t.** 403.221.0833
**tf.** 888.257.1873
**e.** mdonohue@rife.com

## Auditors

**KPMG LLP**

## Bankers

**Canadian Imperial Bank of Commerce**
**Bank of Montreal**
**Royal Bank of Canada**
**The Toronto-Dominion Bank**

## Legal Counsel

**Burnet, Duckworth & Palmer LLP**

## Reserve Evaluators

**Trimble Engineering Associates Ltd.**

## Stock Exchange and Trading Symbol

**Toronto Stock Exchange (TSX)**
**Common Shares: FRU**

## Transfer Agent and Registrar

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