



**KRAKEN ROBOTICS INC.
MANAGEMENT DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED DECEMBER 31, 2017**

This Management Discussion and Analysis (“MD&A”) of Kraken Robotics Inc. (the “Company” or “Kraken”) provides analysis of the Company’s financial results for the year ended December 31, 2017 and should be read in conjunction with the Company’s audited consolidated financial statements and the notes thereto for the year ended December 31, 2017, which are available on SEDAR at www.sedar.com. This MD&A is current as at April 30, 2018, the date of preparation.

The December 31, 2017 financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) applicable to the preparation of interim financial statements. All amounts are expressed in Canadian dollars, unless otherwise stated.

Forward-Looking Statements

Certain statements contained in the following MD&A constitute forward-looking statements. Such forward-looking statements involve a number of known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements.

NATURE OF BUSINESS

Kraken Sonar Inc. (formerly Anergy Capital Inc.) was incorporated on May 14, 2008 under the Business Corporations Act, British Columbia. Its registered office is at 100 King Street West, #1600, Toronto, Ontario, M5X 1G5

On February 18, 2015, Kraken Sonar Systems Inc. and Anergy Capital Inc. (“Anergy”), a company classified as a Capital Pool Company (“CPC”) as defined under Policy 2.4 of the TSX Venture Exchange (the “Exchange”), completed a reverse take-over transaction (“RTO” or “Transaction”) through the closing of a Share Exchange Agreement (the “SEA”) dated November 20, 2014, as amended January 29, 2015. After the RTO, Anergy changed its name to Kraken Sonar Inc. and the Company was continued under the Canada Business Corporations Act (“CBCA”).

For accounting purpose the transaction constitutes a reverse acquisition, as the shareholders of Kraken Sonar Systems Inc. acquired control of the consolidated entity. Kraken Sonar Systems Inc. is considered the acquiring and continuing entity, and Anergy was the acquired entity.

The Company’s principal business is the design, manufacture and sale of underwater sonar and robotics equipment.

Effective September 22, 2017, Kraken Sonar Inc. changed its name to Kraken Robotics Inc. The Company’s Canadian operating subsidiary, Kraken Sonar Systems Inc. has been renamed Kraken Robotic Systems Inc. The name change was intended to reflect the Company’s continued growth as it evolves from manufacturing sensors to supplying complete robotic systems, software and services in the global Unmanned Maritime Systems (“UMS”) market.

At December 31, 2017, the Company had not yet achieved profitable operations, had experienced significant losses and negative cash flows from operations since inception, and had a working capital deficit of \$1,251,562 and a deficit of \$7,359,237 as of December 31, 2017. It may incur further losses in the development of its business. The continued operations of the Company are dependent on its ability to achieve and maintain profitable operations and positive cash flows from operations in the future and upon securing additional financing. There is a risk that additional financing will not be available on a timely basis or on terms acceptable to the Company. These material uncertainties may cast significant doubt on the Company’s ability to continue as a going concern.

Company Overview

Kraken Robotics Inc. (PNG: TSX-V) is a marine technology company supplying advanced sonar and optical sensors and underwater robotics equipment for military and commercial applications. The Company is recognized as world leading innovators of Synthetic Aperture Sonar (SAS) - a revolutionary underwater imaging technology that dramatically improves seabed surveys by providing ultra-high resolution imagery at superior coverage rates.

Both military and commercial markets are showing encouraging growth as they are now incorporating unmanned vehicles and intelligent sensors in their procurement plans and budgets. In fact, industry analyst Market Info Group estimates that the global unmanned maritime systems market will reach \$2 billion by 2020.

AQUAPIX® MINSAS SENSOR FOR UNDERWATER VEHICLES

The AquaPix® MINSAS sensor is based upon Kraken's core Synthetic Aperture Sonar technology. The MINSAS compact receiver array length of only 60cm provides high-resolution 3cm x 3cm imagery at ranges up to 120m per side. The lightweight array is integrated into a modular payload section of less than eight-inch diameter, which can be easily mobilized in customers' Unmanned Underwater Vehicles (UUVs) of all sizes. The MINSAS payload section also includes Kraken's latest generation Real Time SAS Processor, the RTSAS MK-II. The RTSAS enables real-time, onboard processing of SAS imagery and bathymetry, and allows operators to leverage Kraken's suite of post-processing tools, including the newly developed SASView 3D visualization and control software. The MINSAS plus RTSAS provides operators with an area coverage rate of 1km² per hour at full SAS resolution, enabling highly efficient survey operations.

During Q3, Kraken delivered MINSAS sensors to two customers for integration onto their AUVs. These included a leading European defence contractor and Atlas Elektronik, a large German defense contractor.

In September 2017, the Company announced it had been awarded a contract valued at approximately \$3,000,000 by Ocean Infinity. The Company will supply and integrate its AquaPix® solution onboard eight of Ocean Infinity's HUGIN Autonomous Underwater Vehicles (AUV). At December 31, 2017 we recognized revenue on delivery of approximately 47% of the first of four expected purchase orders. The first purchase order was for US\$662,500.

SEAVISION® 3D LASER SYSTEM FOR UNDERWATER VEHICLES

Kraken Robotik GmbH ("KRG"), a wholly-owned subsidiary of the Company, commenced operations in January 2017. Its focus is the development of 3D imaging sensors, machine learning, and artificial intelligence (AI) algorithms for underwater robotic platforms. During Q3, KRG added three world class team members including Dr. Jan Albiez, Patrick Paranhos, and Dr. Sylvain Joyeux. Each of these team members bring strong technical capabilities in the areas of underwater robotics, AI, and machine learning but also relationships across the commercial market and specifically oil and gas. Of note, all 3 were senior technical and project leaders on the BG/Shell FlatFish AUV project in Brazil and helped develop and train a 20-person robotics team in Brazil.

In Q2 2017 at the Ocean Business conference, Kraken Robotik GmbH, introduced its new SeaVision® 3D laser system. SeaVision® is the world's first RGB underwater laser imaging system that offers the resolution, range and scan rate to deliver dense full colour 3D point cloud images of subsea infrastructure with millimetre accuracy in real time. The ability to generate accurate 3D reconstruction of underwater infrastructure is an important requirement for commercial, military and ocean research applications. The initial system is designed for deployment on underwater robotic platforms such as Remotely Operated Vehicles (ROVs) and AUVs.

In Q2 2017, Kraken Robotik GmbH was awarded a contract to design and build a 6,000m rated 3D laser/optical imaging system for the prestigious Alfred Wegener Institute, Helmholtz Centre for Polar and Marine Research (AWI) in Bremerhaven. The custom version of the SeaVision® system was successfully delivered in Q3 and generated revenue of approximately \$160,000.

In September 2017, Kraken Robotik GmbH was awarded the Go-3D prize for its SeaVision® system presented by the Fraunhofer Institute for Computer Graphics Research in association with BITKOM, the German Association for Information Technology, Telecommunications and News Media. The award was established to recognize outstanding technical achievement in the field of 3D visualization.

After completing sea trials in the Baltic Sea in Q1 2018, SeaVision® production units are expected to be available at the end of Q2 2018 and will be sold for approximately \$100,000 per system. Kraken has seen significant interest in SeaVision® from customers across many industries from defense to oil and gas, to renewable energy and nuclear.

KATFISH™ TOWED UNDERWATER VEHICLE

After a multi-year development effort, the Company has developed the Kraken Active Towed Fish (KATFISH™) for high speed, high resolution seabed mapping. The system enables real-time seabed imagery, bathymetry and advanced 3D digital terrain models of the seabed – optimized for both manned and unmanned surface vessels.

KATFISH™ is a high resolution, high speed seabed imaging platform. Coupled with Kraken's revolutionary AquaPix® - Miniature Interferometric Synthetic Aperture Sonar (MINSAS), it is especially well-suited for both military and commercial seabed surveys.

In the commercial seabed survey market, KATFISH™ offers offshore oil and gas exploration and production companies the advantage of comprehensive, high-resolution surveys of existing infrastructure, such as pipelines and subsea stations, completed in at least half the time as more conventional methods. KATFISH™ operates at speeds up to 10 knots, versus the slow moving 1-2 knots of ROV or the medium 3-4 knots of the passively stable sonar systems, thus reducing operating time and cost.

In the defence market, there is a growing global requirement for modernization of mine countermeasures solutions. The previous generation of single-role mine hunting vessels designed and built between the 1970's - 1990's are now being withdrawn from service. This leaves a growing requirement for high resolution, high speed seabed imaging platforms.

The ability of the KATFISH™ platform to generate centimetre-scale sonar resolution in all three dimensions can provide significant improvement in the detection, classification and identification of small seabed objects for both military and commercial seabed survey missions.

Kraken's KATFISH™ product offering sells for US\$1.5 million (Commercial Off The Shelf: COTS) to US\$2.5 million (Military Standard: MIL-STD).

Starting in Q3 2017, Kraken began the build and testing of a MIL-STD version of the KATFISH™. At December 31, 2107, Kraken had two completed KATFISH™ (built for specific customers) which are held in inventory awaiting further testing and planned sea trials and had started the build of a third unit.

Kraken has high expectations for the KATFISH™ which provides high performance underwater mapping and mine hunting capabilities from a towed platform for both the military and commercial markets. The Company has partnered as a supplier to several large defense contractors who are involved in various multi-unit bids, most of which are expecting contract award in 2018 and 2019.

THUNDERFISH® AUTONOMOUS UNDERWATER VEHICLE (AUV)

In March 2017, the Company announced a strategic move to further strengthen its IP portfolio, with the signing of an exclusive licensing agreement for underwater robotics technology with Germany's Fraunhofer Institute for Optronics, System Technologies and Image Exploitation (IOSB). As part of this agreement, Fraunhofer delivered its DeDave AUV to Kraken in June 2017.

Kraken will license Fraunhofer software for use in its ThunderFish® AUV, which is currently under development. The ThunderFish® AUV is technical upgrade of the DeDave AUV, but is still a prototype. Kraken will pay Fraunhofer a royalty based on a percentage of each sale with minimum commitments starting in 2022. Kraken will exclusively license the Fraunhofer software and hardware IP and technology for large AUVs.

Fraunhofer is the largest organization for applied research in Europe with 69 institutes, over 24,500 employees and a €2.1 billion annual budget. Since 2012, Fraunhofer has been developing intellectual property and technology related to underwater robotics. Over C\$6 million has been invested in Fraunhofer's underwater sensor robotics programs, culminating in the development of the DeDave.

In late June, the Company took delivery of the 6000m rated DeDave AUV which Kraken rebranded ThunderFish® Alpha AUV. This AUV is designed for deep sea military, commercial and scientific applications for use as a sensor and robotics technology

demonstration platform to support ongoing development of the Company's underwater sensor and robotics programs. Kraken paid \$378,200 (Euro 250,000) towards the AUV's total cost of Euro 1,000,000. At December 31, 2017, an amount of \$1,110,975 (Euro 750,000) was included in trade payables and accrued liabilities, representing the three remaining quarterly payments- in respect of the acquisition of the AUV.

In addition, Kraken has established a long term technical co-operation program with Fraunhofer for hydrodynamic control systems, mission planning and autonomy algorithms that can be deployed in Kraken's ThunderFish® AUV program. Kraken has committed to granting research and development projects to Fraunhofer of a minimum Euro 300,000 per year for a period of five years. These projects will be expensed as incurred.

Subsequent to year end, Kraken announced that its ThunderFish® 300, a shallow water version of its AUV had been pre-qualified under the Canada's Build in Canada Innovation Program (BCIP). Through the BCIP, companies can sell their pre-qualified innovations to the federal government as their first reference sale. After testing a company's innovation, federal departments provide feedback on the innovation's performance in an operational setting. The program pays up to \$1 million for military innovations. Kraken is currently finalizing the Statement of Work and expects to finalize this contract in Q2 2018.

AUTONOMOUS LAUNCH AND RECOVERY SYSTEMS (ALARS)

Launch and recovery of equipment offshore is one of the most dangerous phases of any ROV or AUV operation. Through the hiring of former Rolls Royce Marine employees in 2016, Kraken's Handling Systems Division has an experienced LARS engineering team with a proven track record. This group has spent two years in R&D mode, working on both an intelligent winch system and an autonomous LARS system that can launch AUVs from vessels, host facilities and docking stations.

Kraken expects products to be announced and available for sale from our Handling Systems Division in 2018. These products range in price from \$200,000 to \$1 million. This group's capabilities are integral to various customer opportunities that Kraken is involved in or pursuing.

ROBOTICS AS A SERVICE (RaaS)

Kraken believes that certain customers would prefer to hire the company to provide product output (i.e. imaging and bathymetry data) to them using the Kraken's own equipment, rather than the customer buying the equipment and having to own and operate and maintain the equipment. This is the genesis of Kraken's RaaS offering. Kraken expects RaaS to become a growing part of its revenue mix over time. Kraken will provide RaaS services to customers using Kraken's KATFISH™ towed underwater vehicles and ThunderFish® AUV.

In Q2, the Company was awarded its first "Robotics as a Service" ("RaaS") contract by OEX Recovery Group Incorporated, to conduct a search for nine Avro Arrow free flight models launched over Lake Ontario in series of tests during 1954 - 1957. The models are one-eighth scale replicas of the famed flying jet, and were part of the final flight design tests done prior to the production of the CF-105 Arrow. The goal of the search was to discover the resting place of nine models, recover them and ultimately house them at the Canada Aviation and Space Museum in Ottawa and the National Air Force Museum of Canada in Trenton, Ontario.

Using Kraken's ThunderFish® underwater robot, the search for the lost Avro Arrow test models occurred in Q3 and Kraken generated revenues of approximately \$475,000 on this contract. The search generated significant national and international media interest when the successful discovery of a free-flight Avro Arrow model on the floor of Lake Ontario was announced September 8, 2017.

KRAKEN POWER GMBH

In May 2017, the Company announced that it had acquired a minority interest in ENITECH Subsea GmbH of Rostock, Germany and that the company has been renamed Kraken Power GmbH. Under the agreement, Kraken had taken a 19.9% equity interest and provided a €110,000 convertible loan. The loan pays interest at 5% per annum and has a term of three years. Through the conversion of the loan to equity and a further investment capped at €200,000, Kraken can choose to increase its ownership stake to 75% of the common shares of Kraken Power GmbH.

Kraken Power GmbH designs and manufactures unique pressure tolerant thrusters, drives, batteries, battery management systems, and electronics. These are specialized deep-sea components for AUVs and ROVs. Kraken Power's technology and products enable a significant reduction in bill of material costs for our ThunderFish® AUV.

Kraken's investment precipitated additional funding in Germany by an arms-length third party involved in regional economic development activities that provided Kraken Power with working capital for operations, hiring of additional personnel and funds for the purchase of inventory and capital assets.

Since being re-capitalized, Kraken Power has successfully restarted operations and is seeing strong international interest in its pressure tolerant encapsulation technology and products from companies providing equipment to the offshore oil and gas market as well as major defense contractors.

FINANCIAL CONTRIBUTIONS AWARDED

Non-refundable financial contributions of up to \$2,636,981 were awarded by governmental agencies during fiscal 2017, which will be used to support the development of the Company's underwater robotics program. At December 31, 2017, the Company had drawn down assistance totaling \$951,748 leaving \$1,685,233 remaining fund research and development activities over the next 4 quarters. Major components of this funding are as follows:

In March 2017, Kraken announced that it will receive a non-refundable financial contribution of up to \$1,470,000 from the National Research Council of Canada Industrial Research Assistance Program (NRC-IRAP). NRC-IRAP's continued backing and assistance in the form of technical and business advisory services and funding is being used to support the development of Kraken's underwater robotics program, which involves development of a technology demonstration platform. The first phase of the program will utilize the Fraunhofer Institute's DEDAVE AUV (now called ThunderFish®) as the base platform. The AUV will be enhanced with hydrodynamic, control system and payload upgrades.

In May 2017, the Company announced that it has been awarded a non-refundable financial contribution of \$745,950 by the Research & Development Corporation (RDC) of Newfoundland and Labrador. Funding will support development of Kraken's ThunderFish® AUV program. The ThunderFish® program will combine smart sonar, laser and optical sensors, advanced pressure tolerant battery and thruster technologies and cutting edge artificial intelligence algorithms integrated onboard a cost effective 6,000 metre depth rated AUV.

On November 2017 the Company entered into a commercial contract with Petroleum Research Newfoundland and Labrador (PRNL) that includes funding from General Electric Oil and Gas and Innovate Newfoundland and Labrador. As part of this agreement, a non-refundable financial contribution from Innovate Newfoundland and Labrador of \$248,324 will be received. Kraken is working with General Electric Oil & Gas to merge Kraken's next generation sensors and underwater robotics, with GE's cloud-based data analytics infrastructure, demonstrating an end-to-end digitized concept of operations for subsea asset integrity management.

RESULTS OF OPERATIONS

Selected Annual Information

	Year Ended December 31, 2017 (\$)	Year Ended December 31, 2016 (\$)	Year Ended December 31, 2015 (\$)	Year Ended December 31, 2014 (\$)
Statement of Comprehensive Loss				
Total Revenues	3,533,605	2,267,818	1,893,299	2,353,982
Cost of Sales	1,936,463	1,017,992	960,542	1,138,540
Loss from operating activities	(3,006,573)	(1,403,388)	(1,784,625)	(848,958)
Net loss	(2,397,229)	(1,420,175)	(1,992,410)	(1,310,240)
Basic and diluted loss per share	(0.03)	(0.02)	(0.03)	(0.03)

	Year Ended December 31, 2017 (\$)	Year Ended December 31, 2016 (\$)	Year Ended December 31, 2015 (\$)	Year Ended December 31, 2014 (\$)
Statement of Financial Position				
Total Assets	5,258,148	2,188,578	2,042,676	2,943,303
Total Current Assets	3,458,421	1,771,898	1,857,733	2,813,957
Total Current Liabilities	4,722,736	1,416,353	1,074,373	3,050,759
Total Liabilities	4,722,736	1,416,353	1,074,373	3,050,759
Total Shareholders' Equity (Deficiency)	535,412	772,225	968,303	(107,456)

*Note: the comparative information for 2014 is that of Kraken Robotic Systems Inc.

** Note: Reclassification of Employee Costs and Government Assistance in Fiscal 2017 and Fiscal 2016 for financial statement presentation purposes has resulted in expense reallocation to Cost of Sales, Research and Development Expense, and Administrative Expense reported in prior periods.

The Company incurred a loss of \$2,397,229 for the year ended December 31, 2017, as compared with a loss of \$1,420,175 for the year ended December 31, 2016. Share-based payments of \$275,600 (2016 - \$143,500) were recorded upon the grant of incentive stock options pursuant to the Company's incentive stock option plan.

During fiscal 2017, the Company continued to ramp-up its business activities, which included establishing a wholly owned subsidiary, Kraken Robotics GmbH. Administrative expenses increased 63% with those of the prior year at \$2,722,486 (2016 - \$1,671,909). Included in the administrative expense were Kraken Robotics GmbH startup costs of \$109,599 (2016 - \$Nil). Research and Development costs, net of related government assistance increased 130% over the prior year at \$1,923,738 (2016 - \$837,805).

No cash dividends have been declared or paid since the date of incorporation and the Company has no present intention of paying dividends on its common shares. The Company anticipates that all available funds will be used to finance the growth of its business.

Summary of Quarterly Information

Selected financial information for each of the eight most recently completed quarters are as follows:

	Revenue (\$)	Operating expenses (\$)	Share-based payments (\$)	Net income (loss) (\$)	Comprehensive (loss) \$	Basic and diluted income (loss) per share (\$)
Q4 2017	1,539,526	1,365,344	144,900	(673,135)	(732,957)	(0.01)
Q3 2017	1,585,664	1,018,855	18,100	109,712	(42,860)	(0.00)
Q2 2017	161,917	909,269	73,600	(1,115,902)	(1,175,008)	(0.01)
Q1 2017	246,498	1,310,247	39,000	(717,904)	(717,904)	(0.01)
Q4 2016	146,644	811,075	35,000	(846,552)	(846,552)	(0.01)
Q3 2016	944,941	561,960	5,900	19,234	19,234	0.00
Q2 2016	465,543	642,772	32,500	(475,261)	(475,261)	(0.01)
Q1 2016	710,690	637,048	70,100	(117,593)	(117,593)	(0.00)

*Note: Reclassification of Employee Costs and Government Assistance in 2017 and 2016 for financial statement presentation purposes has resulted in expense reallocation to Cost of Sales, Research and Development Expense, and Administrative Expense reported in prior periods.

Comparative balance sheet information for 2017 and 2016 is presented below:

	Total Assets (\$)	Total Current Assets (\$)	Total Current Liabilities (\$)	Total Liabilities (\$)
Q4 2017	5,270,901	3,471,174	4,722,736	4,722,736
Q3 2017	5,032,126	3,070,138	3,955,656	3,955,656
Q2 2017	3,661,117	1,670,790	2,559,887	2,559,887
Q1 2017	2,268,631	1,977,338	2,120,310	2,120,310
Q4 2016	2,188,578	1,771,898	1,416,353	1,416,353
Q3 2016	2,571,357	2,173,186	987,579	987,579
Q2 2016	1,740,318	1,469,421	1,254,272	1,254,272
Q1 2016	2,072,517	1,873,698	1,151,710	1,151,710

Three Months Ended December 31, 2017

The Company recorded revenues of \$1,539,526 (2016 - \$146,644) from product sales and services, marking a substantial increase of \$1,392,882 over the same period of the prior year. Product revenue totaled \$1,457,808 (2016 - \$146,644) and Service revenue totaled \$81,718 (2016 - \$Nil). The Company's revenue can fluctuate significantly on a quarterly basis mainly due to the timing of orders and lead times on parts purchases. The Company has not reached the stage yet where it has a steady flow of contracts being fulfilled each quarter. Q4 2017 revenues were up significantly year over year due to a large increase in contract activity in Q3 2017. At the end of the quarter, the Company had recorded deferred revenues of \$491,266 (2016 - \$Nil). The deferred revenues represent customer advances on product orders.

Cost of sales was substantially higher than that of the prior year at \$841,025 (2016 - \$197,971). The Company realized gross profit of \$698,501 (2016 - negative gross profit of \$51,327). Gross margin for the quarter was 45%, as compared to negative 41%, negative 103% and 74% in the first, second and third quarters, respectively. Gross margins improved year-over-year due to the increase in revenues. Our product gross margins generally range from 55%-75% while overall gross margin percentages are lower as labor costs get allocated to cost of sales.

The Company recorded a comprehensive net loss of \$673,134 for the three months ended December 31, 2017, as compared to a comprehensive net loss of \$846,552 for the same period of prior year. An amount of \$59,823 (2016 - \$Nil) is attributable to cumulative translation adjustment arising from the translation of the German subsidiary's financial statements into Canadian dollar presentation currency of the parent company.

Administrative expenses increased by \$537,572 in the quarter to \$955,976 (2016 - \$418,407) due to both an increase in headcount and various administrative expenses such as facilities and public company costs. This amount included travel related costs of \$50,927 (2016 - \$48,232), rent of \$62,644 (2016 - \$33,579), public company costs/transfer agency services fees of \$70,607 (2016 - \$27,990). Accounting and legal costs incurred totaled \$75,910 versus \$73,397 in the prior year. During the quarter the Company realized a foreign exchange gain of \$6,351 (2016 - \$16,776 foreign exchange gain).

Research and development costs ("R&D") costs were higher than those of the fourth quarter in the prior year, totaling \$518,552 (2016 - \$357,668), as a result of the timing of expenditures on various R&D programs and increased R&D employee hiring.

Employee costs, which previously captured all Salaries and Wages, and Government Assistance (which was recorded as a recovery of Administrative Expenses) are now both allocated to Cost of Sales, Administrative Costs, and Research and Development Costs in 2017 and 2016. This reclassification has resulted in changes to the operating expenses reported in prior periods for Research and Development Costs, Administrative Expense, and Cost of Sales on the financial statements.

Government assistance totaled \$688,811 (2016 - \$209,875) during the quarter and was applied against Costs of Sales and R&D expenses. Additionally, the Company had filed Scientific Research and Experimental Development (SR&ED) Expenditures Claim with the Canada Revenue Agency for the fiscal years ended December 31, 2016 and December 31, 2015, which result in refundable Provincial Investment Tax Credits of approximately \$254,083 and \$96,174, respectively (December 31, 2016 - \$Nil).

Share-based compensation of \$144,900 was recorded, representing the fair value of the options that vested during the three months ended December 31, 2017. During the same period of the prior year, the Company recorded stock-based compensation of \$35,000.

Twelve Months Ended December 31, 2017

The Company recorded revenues of \$3,533,605 (2016 - \$2,267,818) from product sales and services, marking an increase of \$1,265,787 or 56% growth from the prior year. The increase in revenue is due to an increase in contract awards for products in 2017 as well as increased service revenues with our first Robotics as a Service (RaaS) job in 2017. At year end, deferred revenues totaled \$491,266 (2016 - \$Nil).

Cost of sales increased from that of the prior year at \$1,936,463 (2016 - \$1,017,992). The Company recorded gross profits of \$1,597,142 (2016 - \$1,249,826), marking an increase of \$347,316 over the prior year. Further, gross margins decreased to 45% over the prior year margins of 55%. Our product gross margins generally range from 55%-75% while overall gross margin percentages are lower as labor costs get allocated to cost of sales. The decrease in gross margin year over year can be largely attributed to a higher proportion of revenue from systems sales (versus sensors) as well as some cost inefficiencies as we start initial production of new systems products.

The Company recorded a comprehensive loss of \$2,668,730 for the year ended December 31, 2017, as compared to a comprehensive loss of \$1,420,175 for the prior fiscal year.

Administrative expenses incurred during the period totaled \$2,722,486 (2016 - \$1,671,909), marking an increase of \$1,050,577 over the prior fiscal year. This amount included accounting and legal costs of \$220,808 (2016 - \$172,278), rent of \$356,720 (2016 - \$143,664), travel related costs of \$250,461 (2016 - \$293,622), public company/transfer agency services fees of \$275,899 (2016- \$153,048) and advertising and promotion of \$49,732 (2016 - \$25,395), most of which are higher due to corporate expansion during 2017. During the year, the Company realized a foreign exchange loss of \$66,593 (2016 - \$5,599).

Research and development costs ("R&D") costs totaled \$1,955,886 (2016 - \$837,805) – representing a 233% increase over the same period of the prior year. Of this increase, approximately \$225,064 was attributable to Kraken Robotik GmbH, the Company's wholly-owned subsidiary. The Company has multiple R&D programs underway – KATFISH™, SeaVision®, ALARS, and ThunderFish®.

Government assistance totaled \$1,566,939 (2016 - \$894,568) during 2017. Additionally, the Company had filed Scientific Research and Experimental Development (SR&ED) Expenditures Claims with the Canada Revenue Agency for the fiscal years ended December 31, 2016 and December 31, 2015, which resulted in refundable Provincial Investment Tax Credits of approximately \$254,083 and \$96,174, respectively (December 31, 2016 - \$Nil).

Share-based compensation of \$275,600 (2016 - \$143,500) was recorded representing the fair value of the options that vested during 2017.

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2017, the Company had working capital deficit of \$1,264,315 (2016 – \$355,545). Cash and cash equivalents as at December 31, 2017 was \$Nil, as compared with \$85,650 at December 31, 2016.

During 2017, the Company closed a non-brokered private placement offering comprised of 11,806,660 units at a purchase price of \$0.18 per Unit for aggregate proceeds of \$2,125,199. Each Unit consisted of one common share and one-half of one common share purchase warrant (each whole common share purchase warrant, a "Warrant"), with each Warrant exercisable to acquire one common share of Kraken at \$0.30 for a period of 24 months from the date of issuance. The Company paid a cash finder's fees of \$12,600 and issued 191,333 finders warrants, and \$73,202 of legal and other costs, in connection with the offering. The Company issued 5,903,330 share purchase warrants in connection with the closing of this non-brokered private placement offering.

During 2017, the Company received proceeds of \$100,000 (2016 - \$8,750) upon the exercise of 666,666 share purchase warrants and an advance payment of \$17,000 in relation to the exercise of 100,000 incentive stock options which were issued subsequent to the end of the year.

During 2017, the Company experienced cash outflows of \$2,038,088 (2016 – \$1,631,233) from operating activities. Investing activities used cash of \$381,947 (2016 – \$289,361), of which \$1,069,868 was used for the purchase of property and equipment and \$864,882 was realized on the disposal of an investment. In the prior year, \$131,951 was used for the purchase of property and equipment and \$157,410 was invested in a private robotics firm. Financing activities realized inflows of \$2,332,765 (2016 – \$1,234,214) and included proceeds of \$2,125,199 from a non-brokered private placement, and \$100,000 received upon warrant exercises.

Overall, cash decreased by \$87,270, as compared to a decrease of \$686,380 during the prior year.

Subsequent to December 31, 2017, the Company completed a non-brokered private placement of 10,714,285 common shares at a price of \$0.14 raising gross proceeds of \$1,500,000. The Company issued 9,000 finder's shares connection with the placement.

In January and February 2018, the Company received proceeds of \$419,761 from 2,888,508 warrants exercisable into one common share at \$0.15 per share with an expiry of February 18, 2018. Of this amount \$100,000 was received in 2017 through early exercise of warrants. The remaining 11,174,918 warrants were not exercised and have expired. Subsequent to year end 2017, the Company also recorded the expiry of 1,310,000 incentive stock options priced at \$0.25, and as well had released from escrow the final 7,647,108 shares remaining as part of the Kraken original RTO transaction.

Further subsequent to year end, the Company entered into a non-revolving term loan facility with RBC that is backed by a customer contract in the amount of \$750,000. The term loan carries interest at prime plus 2.1% and is repayable in full by June 30, 2018.

The Company's continuance as a going concern will depend upon its ability to achieve and maintain profitable operations and positive cash flows from operations in the future and obtain adequate financing if necessary.

RISKS AND UNCERTAINTIES

The Company is a relatively new company with limited operating history and, in addition to facing all of the competitive risks in the underwater sonar and robotics sector it will face all the risks inherent in developing a business including: access to capital, ability to attract and retain qualified employees, ability to attract and maintain customers and the ability to put in place appropriate operating and control procedures routines.

Industry specific risks include, but are not limited to:

- *Competitive risk* – the sonar industry in which the Company operates is highly competitive. The competitors of the Company range from small single product companies to diversified corporations in the military, sonar and marine imaging industry. Some of the competitors of the Company may have more extensive or more specialized engineering, manufacturing, and marketing capabilities;
- *Technology risk* – The future success of the Company will depend on its ability to develop new technologies that achieve market acceptance. The sonar market is characterized by rapidly-changing technologies and evolving industry standards;
- *Protection of Intellectual Property*: The Company may be unable to adequately protect its intellectual property rights, which could affect its ability to compete. Protecting the Company's intellectual property rights is critical to its ability to compete and succeed as a company. The Company currently has trademark registrations and relies on a combination of copyright, trademark, and trade secret laws, confidentiality procedures, contractual provisions and other measures to protect its proprietary information. However, all of these measures afford only limited protection;
- *Outside suppliers*: The Company's operations depend on component availability and the manufacture and delivery by key suppliers of certain products and services. Further, the Company's operations are dependent on the timely delivery of materials by outside suppliers. The Company cannot be sure that materials, components, and subsystems will be available in the quantities required, if at all;
- *Government contracts*: The Company will depend, in part, on government contracts, which may only be partially funded, subject to termination, heavily regulated, and audited. The termination of one or more of these contracts could have a negative impact on the operations of the Company; and

- *Competitive bidding*: The Company will derive significant revenue from contracts awarded through a competitive bidding process, which can impose substantial costs upon it, and the Company could fail to maintain its current and projected revenue if it fails to compete effectively.

An investment in the Company's common shares is highly speculative and subject to a number of risks and uncertainties. Only those persons who can bear the risk of the entire loss of their investment should participate. An investor should carefully consider the risks described above and the other information filed with the Canadian securities regulators before investing in the Company's common shares. The risks described above are not the only ones faced. Additional risks that the Company currently believes are immaterial may become important factors that affect the Company's business. If any of these risks occur, or if others occur, the Company's business, operating results and financial condition could be seriously harmed and investors may lose all of their investment.

RELATED PARTY TRANSACTIONS

During 2017, the Company expensed \$Nil (2016 - \$9,500) in costs for a condominium unit that it rented from an individual related to a member of its management team.

Compensation of key management personnel during 2017 totaled \$540,509 (2016 - \$514,294) comprised of: share-based payments of \$112,500 (2016 - \$98,900); salaries of \$415,308 (2016 - \$403,750); and, short-term benefits of \$12,701 (2016 - \$11,644).

CAPITAL MANAGEMENT

The Company's objectives when managing its capital are to maintain a financial position suitable for supporting its operations and growth strategies, to provide an adequate return to shareholders and to meet its current obligations.

The Company's capital structure consists of shareholders' equity (deficiency). The Company makes adjustments to the capital structure depending on economic conditions, its financial position and performance. In order to maintain or adjust the capital structure, the Company may issue new shares, buyback shares or pay dividends, issue new debt and sell assets to reduce debt.

FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

As at December 31, 2017, the Company's risk exposures and the impact of the Company's financial instruments are summarized below:

Credit Risk:

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

	December 31, 2017	December 31, 2016
Cash (bank indebtedness)	\$ (326,448)	\$ 85,650
Trade and other receivables	1,487,373	550,696
Note Receivable	154,183	-
Share subscriptions receivable	76,833	76,833
Derivative asset	9,491	-
	\$ 1,401,432	\$ 713,179

The Company manages credit risk by holding the majority of its cash with high quality financial institutions in Canada, where management believes the risk of loss to be low.

The share subscriptions receivable is related to the exercise price of stock options exercised by employees during the year ended December 31, 2014.

Liquidity Risk:

Liquidity risk is the risk that the Company will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions. As at December 31, 2017, the Company had a cash and cash equivalents balance of \$Nil (2016- \$85,650), to settle current liabilities of \$4,722,736 (December 31, 2016 - \$1,416,353).

Market Risk:

Market risk is the risk of loss that may arise from changes in market factors such as interest rates, foreign exchange rates, and commodity and equity prices.

(a) Interest rate risk

At December 31, 2017, the Company held a cash balance of \$Nil and had drawn \$326,448 against its line of credit (2016 - \$150,000). The Company is not currently exposed to any significant interest rate risk.

(b) Foreign currency risk

The Company's exposure to foreign currency risk is limited to sales in USD, GDP and EUR, certain purchases of inventory in USD, GBP and EUR, and its note receivable. The Company does not use any form of hedging against fluctuations in foreign exchange.

Fair Value:

During the year ended December 31, 2017, there were no transfers between level 1, level 2 and level 3 classified assets and liabilities. The fair values of the Company's financial instruments are considered to approximate the carrying amounts.

The following table provides the disclosures of the fair value and the level in the hierarchy:

December 31, 2017	Level 1	Level 2	Level 3
Financial assets classified as loans and receivables:			
Cash	\$ -	\$ -	\$ -
Trade and other receivables	-	1,487,373	-
Investment tax credits recoverable	-	350,257	-
Note receivable	-	154,183	-
Derivative asset	-	-	9,491
Investment	-	-	30,530
Share subscription receivables	-	76,833	-
Financial liabilities at amortized cost:			
Bank indebtedness	-	326,448	-
Trade and other payables	-	3,905,022	-
December 31, 2016	Level 1	Level 2	Level 3
Financial assets classified as loans and receivables:			
Cash	\$ 85,650	\$ -	\$ -
Trade and other receivables	-	550,696	-
Share subscription receivables	-	76,833	-
Financial liabilities at amortized cost:			
Bank indebtedness	-	150,000	-
Trade and other payables	-	1,266,353	-

OFF-BALANCE SHEET ARRANGEMENTS

The Company has no off-balance sheet arrangements as of December 31, 2017 and as at the date of this MD&A.

USE OF ESTIMATES AND JUDGMENTS

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates. Estimates are reviewed on an ongoing basis based on historical experience and other factors that are considered to be relevant under the circumstances. Revisions to estimates on the resulting effects of the carrying amounts of the Company's assets and liabilities are accounted for prospectively.

All of the Company's significant accounting policies and estimates and judgments are included in Notes 3 and 4 of its audited consolidated financial statements for the year ended December 31, 2017.

SUBSEQUENT EVENTS

Subsequent to December 31, 2017, the Company:

- (a) entered into a non-revolving term loan facility backed by a customer contract that was not billed at year end for \$750,000 from RBC, interest at prime plus 2.1% and is repayable in full by June 30, 2018;
- (b) released from escrow the final 7,647,108 shares remaining as part of Kraken original RTO transaction;
- (c) received proceeds of CDN \$419,761 from 2,888,508 warrants exercisable into one common share at CDN\$0.15 per share with an expiry of February 18, 2018. Of this amount, CDN \$100,000 was received in 2017 through early exercise of warrants. The remaining 11,174,918 warrants were not exercised and have expired;
- (d) completed a non-brokered private placement of 10,714,285 common shares at a price of \$0.14 raising gross proceeds of \$1,500,000. The Company issued 9,000 finder's shares connected with the placement;
- (e) renewed its investor relations advisory agreement with a monthly cost of \$7,000 and granted 450,000 incentive stock options to a consultant at an exercise price of \$0.185 for a period of three years and will vest in equal quarterly installments over one-year;
- (f) issued 100,000 common shares priced at \$0.17 per share in relation to advance stock options exercise proceeds recorded in December 2017, and recorded the expiry of 1,310,000 incentive stock options priced at \$0.25;
- (g) announced a strategic alliance with Thayer Mahan, US based systems integrator specializing in maritime autonomous systems. Both companies are collaborating to deliver next generation underwater sensors and robotics for military, law enforcement, port and maritime security and environmental monitoring applications; and,
- (h) announced pre-qualification of ThunderFish® for Canada's BCIP program. Under this program, Kraken may receive up to \$1 million for its ThunderFish® 300 military version of its AUV.

FUTURE ACCOUNTING STANDARDS AND INTERPRETATIONS

Certain new accounting standards and interpretations have been published that are not mandatory for the current reporting period. These standards have been assessed to not have a significant impact on the Company's financial statements:

FUTURE ACCOUNTING PRONOUNCEMENTS

A number of new standards, and amendments to standards and interpretations under IFRS, are not yet effective and have not been applied in preparing these consolidated financial statements.

IFRIC 23, Uncertainty over Income Tax Treatments:

The Interpretation provides guidance on the accounting for current and deferred tax liabilities and assets in circumstances in which there is uncertainty over income tax treatments. It requires an entity to contemplate whether uncertain tax treatments should be considered separately, or together as a group, based on which approach provides better predictions of the resolution. Probability will be determined whether the tax authorities will accept the uncertain tax treatment, and if it is not probable that the uncertain tax treatment will be accepted, they will measure the tax uncertainty based on the most

likely amount or expected value, depending on whichever method better predicts the resolution of the uncertainty. The Company intends to adopt the Interpretation in its financial statements for the annual period beginning on January 1, 2019. The Company does not expect the Interpretation to have a material impact on the financial statements.

IFRS 15, Revenue from Contracts with Customers:

The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimated and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized. The Company intends to adopt IFRS 15 in its consolidated financial statements for the annual period beginning on January 1, 2018. While the extent of the impact of adoption of the standard has not yet been determined, the Company does not expect to be able to apply percentage of completion method for revenue recognition on product sales going forward. As such, quarterly revenue results could be more variable as certain product orders take more than one quarter from order to shipment.

IFRS 9, Financial Instruments:

IFRS 9, Financial Instruments, will replace IAS 39, Financial Instruments: Recognition and Measurement, and some of the requirements of IFRS 7, Financial Instruments: Disclosures. The Objective of IFRS 9 is to establish principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity’s future cash flows. The IASB has determined the revised effective date for IFRS 9 will be for annual periods beginning on or after January 1, 2018. The Company has not completed the assessment of this impact of the change to the consolidated financial statements based on the characteristics of financial instruments outstanding at the time of adoption.

IFRS 16, Leases:

In January 2016, the IASB issued IFRS 16 *Leases*. This standard introduces 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. This standard substantially carries forward the lessor accounting requirements of IAS 17, while requiring enhanced disclosures to be provided by lessors. Other areas of the lease accounting model have been impacted, including the definition of a lease. Transitional provisions have been provided. The new standard is effective for annual periods beginning on or after January 1, 2019. The extent of the impact of adoption of the standard has not yet been determined.

Amendments to IFRS 2, Share-based Payments:

In June 2016, the IASB issued amendment to IFRS 2, Shares-based Payments, clarifying how to account for certain types of share-based payment transactions. The amendments provide requirements on the accounting for a) the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments; b) share-based payment transactions with a net settlement feature for withholding tax obligations; and c) a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled. The amendments apply for annual periods beginning on or after January 1, 2018. As a practical simplification, the amendments can be applied prospectively. The Company intends to adopt the amendments to IFRS 2 in its financial statements for the annual period beginning on January 1, 2018. The extent of the impact of adoption of the standard has not yet been determined.

OUTSTANDING SHARE DATA AS AT APRIL 30, 2018:

- (a) Authorized and issued share capital:

Class	Par Value	Authorized	Issued Number
Common	No par value	Unlimited	104,037,767

(b) Summary of options outstanding:

Security	Number	Number Exercisable	Exercise Price	Expiry Date
Options	250,000	250,000	0.20	May 13, 2018
Options	100,000	100,000	0.21	July 1, 2018
Options	600,000	500,000	0.15	October 12, 2019
Options	300,000	200,000	0.15	December 1, 2019
Options	2,000,000	1,250,000	0.21	June 1, 2020
Options	150,000	87,500	0.17	March 8, 2020
Options	350,000	116,667	0.17	September 20, 2020
Options	300,000	100,000	0.18	October 4, 2020
Options	1,770,000	590,000	0.18	December 18, 2020
	5,470,000	2,894,167		

(c) Summary of warrants outstanding:

Security	Number	Exercise Price	Expiry Date
Warrants	3,579,767	0.30	August 12, 2018
Warrants	116,666	0.30	August 22, 2018
Warrants	5,903,330	0.30	April 11, 2019
	9,599,763		

(d) Summary of escrowed shares: At the date of this report, there are no common shares subject to escrow restrictions. The final escrow shares were released February 18, 2018.

DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

Disclosure controls and procedures (“DC&P”) are intended to provide reasonable assurance that material information is gathered and reported to senior management to permit timely decisions regarding public disclosure. Internal controls over financial reporting (“ICFR”) are intended to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with IFRS accounting principles.

TSX Venture-listed companies are not required to provide representations in their annual and interim filings relating to the establishment and maintenance of DC&P and ICFR, as defined in Multinational Instrument MI 52-109. In particular, the CEO and CFO certifying officers do not make any representations relating to the establishment and maintenance of (a) controls and other procedures designed to provide reasonable assurance that information required to be disclosed by the issuer in its annual filings, interim filings or other reports filed or submitted under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation, and (b) processes to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with the issuer’s GAAP.

OTHER INFORMATION

Additional information regarding the Company is available on SEDAR at www.sedar.com and on the Company’s website at www.krakenrobotics.com.