Kraken Robotics Inc.

Condensed Consolidated Interim Financial Statements

For the six months ended June 30, 2018 and 2017
(Expressed in Canadian Dollars)

(Unaudited)

Q2 Fiscal 2018

June 30, 2018

NOTICE TO READER

Under National Instrument 51-102, subsection 4.3(3)(a), if an auditor has not performed a review of the interim financial statements they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited condensed consolidated interim financial statements of Kraken Robotics Inc. as at June 30, 2018 and for the three and six months ended June 30, 2018 and 2017, notes to unaudited condensed consolidated interim financial statements and related Management's Discussion and Analysis have been prepared by and are the responsibility of management.

The Company's independent auditor has not performed a review of these condensed consolidated interim financial statements in accordance with the standards established by the Chartered Professional Accountants - Canada for a review of interim financial statements by an entity's auditor.

KRAKEN

June 30, 2018

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Condensed Consolidated Statement of Financial Position
(Unaudited)
(Expressed in Canadian Dollars)

	June 30, 2018	December 31, 2017 *
ASSETS		
Current assets:		
Cash	**$ 2,340,855**	$ -
Trade and other receivables (note 6)	**1,049,859**	1,487,373
Investment tax credits recoverable (note 7)	**320,807**	350,257
Inventory (note 8)	**2,451,537**	1,530,508
Prepayments (note 9)	**238,743**	90,283
	6,401,801	3,458,421
Note receivable (note 10)	**165,164**	163,674
Investment (note 10)	**30,530**	30,530
Property and equipment (note 11)	**1,500,398**	1,605,523
TOTAL ASSETS	**$ 8,097,893**	$ 5,258,148
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Bank indebtedness (note 13)	**$ -**	$ 326,448
Trade and other payables	**4,078,868**	3,905,022
Deferred revenue	**1,841,962**	491,266
	5,920,830	4,722,736
Shareholders' equity:		
Share capital (note 14)	**10,699,177**	6,008,347
Contributed surplus	**1,665,798**	2,157,803
Accumulated other comprehensive loss	**(433,596)**	(271,501)
Deficit	**(9,754,316)**	(7,359,237)
	2,177,063	535,412
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**$ 8,097,893**	$ 5,258,148

* The Company applied IFRS 15 using the cumulative effect method. Under this method, the comparative information is not restated. Refer to note 4.

Going concern (note 2)
Commitment (note 18)
Subsequent event (note 19)

On Behalf of the Board:

"Karl Kenny" Director *"Shaun McEwan"* Director

KRAKEN

Condensed Consolidated Interim Statements of Net Income (Loss)
(Unaudited)
(Expressed in Canadian Dollars)

	Three months ended		Six months ended	
	June 30, 2018	June 30, 2017	**June 30, 2018**	June 30, 2017 *
Product Revenue	**$ 3,684,979**	$ 161,917	**$ 3,684,979**	$ 408,415
Service Revenue	**41,668**		**41,668**	-
	3,726,647	161,917	**3,726,647**	408,415
Cost of sales (note 8)	**1,416,742**	328,956	**1,650,889**	675,744
	2,309,905	(167,039)	**2,075,758**	(267,329)
Administrative expenses	**825,160**	630,798	**1,581,625**	1,215,654
Research and development costs	**683,986**	301,045	**1,345,443**	987,435
Share-based compensation (note 14(c))	**85,300**	73,600	**111,400**	112,600
Investment tax credits recoverable	**-**	(96,174)	**(320,807)**	(96,174)
Income (loss) from operating activities	**715,459**	(1,076,308)	**(641,903)**	(2,486,844)
Foreign exchange loss (gain)	**62,390**	49,178	**141,233**	47,680
Financing costs – line of credit	**14,628**	4,178	**35,350**	6,844
Unrealized gain on sale of investment	**-**	313,622	**-**	-
Gain on sale of investment (note 10)	**-**	(327,384)	**-**	(707,562)
Net Income (loss) for the period	**$ 638,441**	$ (1,115,902)	**$ (818,486)**	$ (1,833,807)
Basic and diluted income (loss) per share	**$ 0.01**	$ (0.01)	**$ (0.01)**	$ (0.02)
Basic and diluted weighted average number of shares outstanding	**105,303,701**	89,338,089	**100,761,196**	89,338,089

* The Company applied IFRS 15 using the cumulative effect method. Under this method, the comparative information is not restated. Refer to note 4.

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Condensed Consolidated Interim Statements of Comprehensive Income (Loss)
(Unaudited)
(Expressed in Canadian Dollars)

	Three months ended		Six months ended	
	June 30, 2018	**June 30, 2017**	**June 30, 2018**	**June 30, 2017 ***
Income (loss) for the period	**$ 638,441**	$ (1,115,902)	**$ (818,486)**	$ (1,833,807)
Other comprehensive income (loss)				
Items that may be reclassified to profit or loss				
Currency translation adjustment	**9,318**	(59,106)	**(162,095)**	(59,106)
Other comprehensive income (loss) for the period	**9,318**	(59,106)	**(162,095)**	(59,106)
Comprehensive income (loss) for the period	**$ 647,759**	$ (1,175,008)	**$ (980,581)**	$ (1,892,913)

* The Company applied IFRS 15 using the cumulative effect method. Under this method, the comparative information is not restated. Refer to note 4.

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Condensed Consolidated Interim Statements of Changes in Shareholders' Equity
(Unaudited)
(Expressed in Canadian Dollars)

2018

	Number of Shares	Share capital (note 13)	Contributed Surplus	Cumulative Translation Adjustment	Deficit	Total
Balance at January 1, 2018	**90,992,740**	**$ 6,008,347**	**$ 2,157,803**	**$(271,501)**	**$ (7,359,237)**	**$ 535,412**
Net loss	-	-	-	-	**(818,486)**	**(818,486)**
Adjustment to deficit - change in accounting policy (note 4)	-	-	-	-	**(1,576,594)**	**(1,576,594)**
Other comprehensive loss	-	-	-	**(162,095)**		**(162,095)**
Transactions with shareholders, recorded directly in equity:						
Issue of common shares on private placement	**22,234,285**	**3,142,900**	**661,100**	-	-	**3,804,000**
Issue of common shares on warrant exercises	**2,221,742**	**540,533**	**(207,271)**	-	-	**333,262**
Issue of common shares as Finder's fee	**9,000**	**1,260**	-	-	-	**1,260**
Issue of common shares on exercise of stock options	**100,000**	**14,700**	**(14,700)**	-	-	-
Expiry of warrants	-	**1,042,534**	**(1,042,534)**	-	-	-
Share-based compensation (note 13)	-	-	**111,400**	-	-	**111,400**
Share issue costs	-	**(51,096)**				**(51,096)**
Shareholders' equity as at June 30, 2018	**115,557,767**	**$ 10,699,177**	**$ 1,665,798**	**$(433,596)**	**$ (9,754,316)**	**$ 2,177,063**

2017

	Number of Shares	Share capital (note 10)	Contributed Surplus	Cumulative Translation Adjustment	Deficit	Total
Balance at January 1, 2017	**78,519,414**	**$ 4,086,270**	**$ 1,647,963**	$ -	**$ (4,962,008)**	**$ 772,225**
Net loss	-	-	-	-	**(717,904)**	**(717,904)**
Transactions with shareholders, recorded directly in equity:						
Issue of common shares on private placement	-	-	-			-
Issue of common shares on warrant exercises	366,666	87,200	(32,200)			**55,000**
Issue of common shares for debt settlement	-	-	-			-
Share issue costs	-	-	-			-
Share-based compensation	-	-	39,000	-	-	**39,000**
Shareholders' equity as at June 30, 2017	**78,886,080**	**$ 4,173,470**	**$ 1,654,763**	**$ -**	**$ (5,679,912)**	**$ 148,321**

The accompanying notes form part of the consolidated financial statements.

KRAKEN

Condensed Consolidated Interim Statements of Cash Flow
(Unaudited)
For the Six Months Ended June 30, 2018 and 2017

	June 30, 2018	June 30, 2017 *
Cash flows used in operating activities		
Net loss	**$ (818,486)**	$ (1,833,806)
Adjustments for items not involving cash:		
Depreciation	**120,230**	40,619
Share-based payments	**111,400**	112,600
Non-cash finance costs	**(2,037)**	-
Investment Tax Credit	**(320,807)**	(96,174)
Gain on sale of investment	**-**	(707,562)
Changes in non-cash working capital	**(496,344)**	215,350
Net cash flows used in operating activities	**(1,406,044)**	(2,268,973)
Cash flows from (used in) investing activities		
Proceeds on disposal of investment (note 10)	**-**	864,882
Investment, note receivable and derivative asset (note 10)	**546**	(191,200)
Purchase of property, plant and equipment	**(15,113)**	(467,138)
Decrease in bank indebtedness	**(326,448)**	(114,467)
	(341,015)	92,077
Cash flows from (used in) financing activities		
Proceeds from private placement	**3,804,000**	2,125,199
Proceeds from exercise of warrants	**333,262**	70,000
Share issue costs	**(49,836)**	(85,882)
Proceeds from short-term note payable	**-**	-
	4,087,426	2,109,317
Net increase (decrease) in cash	**2,340,367**	(67,579)
Effect of foreign exchange on cash	**488**	(2,272)
Cash at beginning of period	**-**	85,650
Cash at end of period	**$ 2,340,855**	**$ 15,799**

* The Company applied IFRS 15 using the cumulative effect method. Under this method, the comparative information is not restated. Refer to note 4.

1. Corporate Information:

Kraken Robotics Inc. ("Kraken" or the "Company") (formerly Kraken Sonar Inc.) was incorporated on May 14, 2008 under the *Business Corporations Act, British Columbia*), is a publicly traded company, and its registered office is located at 100 King Street. West, #1600, Toronto, Ontario, M5X 1G5.

The Company's principal business is the design, manufacture and sale of software-centric sensors and underwater robotic systems.

2. Going concern:

These condensed consolidated interim financial statements have been prepared on a going concern basis, which assumes the Company will continue in operation for the foreseeable future and be able to realize its assets and discharge its liabilities and commitments in the normal course of business. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period. Management is aware, in making its assessment, of material uncertainties related to events or conditions that cast significant doubt upon the Company's ability to continue as a going concern, as the Company experienced significant losses and negative cash flows from operations since inception and at June 30, 2018 has working capital of $480,971 and a deficit of $9,754,316 (December 31, 2017 working capital deficit of $1,264,315 and a deficit of $7,359,237).

The ability of the Company to continue as a going concern and to realize its assets and discharge its liabilities when due is dependent on its ability to achieve and maintain profitable operations and positive cash flows from operations in the future and/or upon securing additional financing. The timing and availability of additional financing will be determined largely by the performance of the Company and market conditions and there is no certainty that the Company will be able to raise funds as they are required in the future.

These condensed consolidated interim financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis was not appropriate, then adjustments would be necessary in the carrying amount of assets and liabilities, the reported revenues and expenses, and the statement of financial position classifications used.

3. Basis of presentation:

(a) Statement of compliance:

These condensed consolidated interim financial statements, including comparatives, have been prepared in accordance with IAS 34, Interim Financial Reporting as issued by the International Accounting Standards Board ("IASB"). These financial statements were prepared using the same accounting policies and methods of computation and are subject to the same use of estimates and judgments, as the Company's consolidated financial statements for the year ended December 31, 2017, except as noted below in Note 4.

These condensed consolidated interim financial statements do not include all disclosures required by International Financial Reporting Standards ("IFRS") for annual consolidated financial statements and accordingly should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2017.

This is the first year where IFRS 15 and IFRS 9 have been applied. Changes to significant accounting policies are disclosed in note 4.

These consolidated financial statements were approved by the Board of Directors on August 29, 2018.

3. Basis of presentation (continued):

(b) Basis of measurement and reclassification of comparative figures

These consolidated interim financial statements have been prepared on a historical cost basis, except for investment and note receivable, which are recorded at fair value through profit or loss.

These consolidated interim financial statements are presented in Canadian dollars, which is the Company's functional and presentation currency.

Due to increased growth in revenue and employee base, detailed time tracking has been implemented for improved accounting. As a result, comparative figures for Wages and Benefits that were previously presented as Employee Costs have been reclassified for presentation purposes to Cost of Sales, Research and Development and Administrative expenses. In addition, Government Assistance that was previously reported separately has been reclassified as a reduction to these amounts and allocated by department accordingly (refer to note 16).

(c) Accounting estimates and judgments:

The significant judgments made by Management in applying the Company's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the consolidated financial statements as at and for the year ended December 31, 2017, except for significant judgments and key sources of estimation uncertainty related to the application of IFRS 15 and IFRS 9, as described in note 4.

4. Change in accounting policies:

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 has adopted IFRS 15 with a date of initial application of January 1, 2018 using the cumulative effect method of adoption, and accordingly the comparative figures in 2017 in the Company's unaudited condensed interim consolidated financial statements have not been restated.

The Company's revenue is derived from product sales and services. Revenue is recognized upon transfer of control of promised products or services to the customers and at an amount that reflects the consideration the Company expects to receive in exchange for those products and services. Professional services are primarily related to contract research, training and integration.

Product revenue is generally recognized at a point in time upon delivery to the customer. A product or service is distinct if the customer can benefit from it on its own or together with other readily available resources, and the Company's promise to transfer the good or service is separately identifiable from other promises in the contractual arrangement with the customer. In certain contracts, there is significant integration work to enable the Company's product to work on the customer's vessel or underwater vehicle. This is the case on some legacy contracts that include both product and integration in one contract. In these contracts (and where the Company only can provide the integration work), revenue is recognized not upon shipment to the customer, but upon final integration with the customer's equipment.

Service revenue is recognized over time as the services are delivered to the customer. When contracted on a fixed fee basis, revenue is generally recognized progressively by reference to the stage of completion of the contract, measured by the cost incurred to date in relation to the total expected cost to complete the deliverable, commonly referred to

4. Change in accounting policies (continued):

as the percentage-of-completion method. For contracts billed on a time and materials basis, the Company invoices the customer and recognizes revenue equal to the amount of time incurred during the period. If the estimated cost to complete a contract increases over the life of the contract resulting in a loss on the contract, the loss is recognized immediately into the consolidated statement of loss and comprehensive loss.

When a contract includes more than one performance obligation, the total amount of consideration to be received is allocated to distinct products and services based on the stand-alone selling price ("SSP") for each of the products and services in the customer contract, which is typically determined based on the price at which the Company separately sells or would separately sell each product or service.

The Company has elected to apply the practical expedient to not adjust the total consideration over the contract term for the effect of a financing component if the period between the transfer of services to the customer and the customer's payment for these services is expected to be one year or less.

Significant judgments and estimates:

Application of the accounting principles related to measurement and recognition of revenue requires the Company to make judgements and estimates. The Company uses judgement to assess if its products and services are distinct, and should be accounted for as separate performance obligations, or together as a combined performance obligation. In arrangements with multiple performance obligations, estimates are required to allocate revenue to each performance obligation in the contract.

For service contracts, the Company exercises judgement in determining the appropriate measure of progress for recognizing revenue over time. Estimates of proportional performance are required to recognize revenue including effort spent to date versus the total expected effort to deliver the services. When a percentage of completion estimate is used, estimates related to cost to complete are routinely revised based on changes in the facts relating to each contract.

Impact of Adoption of IFRS 15:

The Company applied IFRS 15 using the cumulative effect method and has recognized the cumulative effect of initially applying IFRS 15 as an adjustment to the opening balance of equity at January 1, 2018. The comparative information has not been restated and continues to be reported under IAS 18 and IAS 11.

Previously, the Company recorded revenue from product sales using the percentage of completion basis. At the date of application of IFRS 15, the specific contracts in progress at the time did not meet the criteria in IFRS 15 to permit the recognition of revenue over time. As a result, amounts received in respect of such product sales have been reclassified from revenue to deferred revenue and amounts recorded in cost of sale have been reclassified to work on progress. The following table summarizes the impact of the transition to IFRS 15 on the Company's opening deficit at January 1, 2018:

	Balances as at December 31, 2017	**IFRS 15 Adjustments**	**Balances as at January 1, 2018**
Assets			
Trade and other receivables	$ 1,487,373	**$ (885,833)**	$ 601,540
Inventory WIP	1,530,508	**1,197,785**	2,728,293
Liabilities			
Deferred Revenue	(491,266)	**(1,888,546)**	(2,379,812)
Equity			
Deficit	7,359,237	**1,576,594**	8,935,831

4. Change in accounting policies (continued):

IFRS 9, Financial Instruments:

IFRS 9, Financial Instruments, replaces 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 initial application date for IFRS 9 is January 1, 2018.

IFRS 9 largely retains the existing requirements in IAS 39 for the classification and measurement of financial liabilities. However, it eliminates the previous IAS 39 categories for financial assets of held-to-maturity, loans and receivables, and available for sale. The classification of financial assets under IFRS 9 is generally based on the business model in which a financial asset is managed and its contractual cash flow characteristics. Derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never separated. Instead, the hybrid financial instrument as a whole is assessed for classification.

Cash and cash equivalents, and receivables that were classified as loans and receivables under IAS 39 are classified as financial assets measured at amortized cost. There is no change to the initial measurement of these financial assets.

The investment in Kraken Power GmBH is classified as fair value through profit or loss. The note receivable and embedded conversion option that were previously accounted for separately under IAS 39 are classified together under IFRS 9 as fair value through profit or loss, whereas under IAS 39, the note receivable was measured at amortized cost and the derivative asset was carried at fair value through profit or loss.

IFRS 9 also replaces the 'incurred loss' model in IAS 39 with an expected credit loss ("ECL") model. ECL's are a probability-weighted estimate of credit losses. The Company calculated ECL's based on consideration of customer-specific factors and factual credit loss experience over the past five years. Excluding a bad debt expense from a single customer in 2016 the Company's actual credit loss has not been material.

5. Significant accounting policies:

(a) Application of new or revised IFRS and interpretations:

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 has adopted the amendments to IFRS 2 in its financial statements for the annual period beginning on January 1, 2018. The Company has evaluated the impact on the financial statements of the Amendments to IFRS 2 and concluded there was no impact to the financial statements.

5. Significant accounting policies (continued):

(b) Future changes in accounting policies:

A number of new standards, and amendments to standards and interpretations under IFRS, are not yet effective for the year ended December 31, 2018, 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 labilities 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 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.

6. Trade and other receivables:

Trade and other receivables consist of the following:

	June 30, 2018	December 31, 2017
Trade and unbilled receivables	$ 804,129	$ 1,054,958
Government assistance receivable and other	245,730	432,415
	$ 1,049,859	$ 1,487,373

7. Investment tax credit receivable

At June 30, 2018, the Company had filed its Scientific Research and Experimental Development (SR&ED) Expenditures Claim for the year ended December 31, 2017 and is entitled to a refundable Provincial Investment Tax Credit of approximately $320,807 (December 31, 2017 - $350,257) from the Canada Revenue Agency (CRA). The December 31, 2017 balance represents SR&ED for the years ending 2015 and 2016 which were subsequently paid during the first three months ending March 31, 2018.

8. Inventory

At June 30, 2018, cost of sales for the six months ended June 30, 2018 included inventory of $1,183,787 (2017 -$262,568)

9. Prepayments

As at June 30, 2018, the Company had made prepayments of $195,179 (2017 - $140,765) towards inventory, of which 89% of the total represented one vendor.

10. Note receivable and Investment

(a) During 2016, the Company entered into an agreement with Square Robot, Inc., a private US-based company, in respect of the co-design of small robots for large above ground storage tanks. Pursuant to the agreement, as at December 31, 2016, the Company had invested CAD$157,320 (US$120,000) in the company.

During the first quarter of Fiscal 2017, the Company disposed of its investment in Square Robot Inc., a non-core asset, for consideration of US$700,000, half of which was received on February 28, 2017, with the balance in the form of a note receivable due no later than June 27, 2017. Subsequently, the Company reduced the amount owing from $458,835 (US$350,000) to $393,287 (US$300,000) in exchange for early settlement of the note receivable which occurred on May 15, 2017. The net result of this activity was a gain on sale of investment of $707,562.

(b) During the second quarter of Fiscal 2017, the Company acquired a minority interest in ENITECH Subsea GmbH of Rostock, Germany and that company has been renamed Kraken Power GmbH. Under the agreement, Kraken has taken a 19.9% equity interest for €20,520 ($30,530) and provided a €110,000 (CAD $168,960) 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, the Company may acquire a further 55.1% equity interest, for an aggregate 75% ownership stake position, in Kraken Power GmbH.

The Company does not have any power or significant influence over Kraken Power GmbH, so the investment is classified as available for sale and has been recorded at fair market value. The note receivable is recorded at amortized cost, which was €110,000 (CAD $157,571) at June 30, 2018. The conversion option is a derivative financial asset that is recorded at fair value, with changes in fair value recognized through profit or loss. The premium paid for the derivative at inception of $11,389 represents the initial fair value, which was determined using an option pricing model. The fair value has been estimated based on amortizing the premium on a straight-line basis over the term of the option agreement.

The Company uses cost as an approximation of fair value for the investment in equity securities of Kraken Power GmBH as well as the convertible note receivable as the shares of the company are unquoted and the settlement of the convertible note is linked to these shares and the most recent available financial information is not sufficient to determine fair value.

11. Property and equipment

	Furniture and Equipment	Computer equipment	Computer software	Leasehold improvements	AUV Vehicle	Total
Cost						
Balance at December 31, 2016	**$ 92,181**	**$ 56,359**	**$ 121,146**	**$ 104,888**	**$ -**	**374,574**
Additions (adjustments)	26,590	34,785	(121,146)	10,789	1,489,175	1,440,193
Balance at December 31, 2017	**$ 118,771**	**$ 91,144**	**$ -**	**$ 115,677**	**$ 1,489,175**	**1,814,767**
Additions	1,880	13,234	-	-	-	15,114
Balance at June 30, 2018	**$ 120,651**	**$ 104,378**	**$ -**	**$ 115,677**	**$ 1,489,175**	**$ 1,829,881**

	Furniture and Equipment	Computer equipment	Computer software	Leasehold improvements	AUV Vehicle	Total
Depreciation						
Balance at December 31, 2016	**$ 19,747**	**$ 20,488**	**$ 37,960**	**$ 37,019**	**$ -**	**$ 115,214**
Depreciation (adjustments)	12,192	23,784	(37,960)	18,763	77,251	94,030
Balance at December 31, 2017	**$ 31,939**	**$ 44,272**	**$ -**	**$ 55,782**	**$ 77,251**	**$ 209,244**
Depreciation	6,365	11,161	-	9,640	93,073	120,239
Balance at June 30, 2018	**$ 38,304**	**$ 55,433**	**$ -**	**$ 65,422**	**$ 170,324**	**$ 329,483**
Carrying amounts						
At December 31, 2016	**$ 72,434**	**$ 35,871**	**$ 83,186**	**$ 67,869**	**$ -**	**$ 259,360**
At December 31, 2017	**$ 86,831**	**$ 48,872**	**$ -**	**$ 59,895**	**$ 1,411,924**	**$ 1,605,523**
At June 30, 2018	**$ 82,347**	**$ 48,945**	**$ -**	**$ 50,255**	**$ 1,318,851**	**$ 1,500,398**

12. Financial instruments:

Credit Risk:

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

	June 30, 2018	December 31, 2017
Trade and other receivables	1,049,859	1,487,373
Note receivable	165,164	163,674
Share subscription receivable	76,833	76,833
	$ 1,291,856	$ 1,727,880

Revenues from the top 2 customers represented 82% and 82% of the Company's revenue in both the three and six months ended June 30, 2018, respectively (2017 – top 2 customers represented 68% and 83%). At June 30, 2018, 87% of the trade receivables balance was owing from 2 customers (2017 – 68% of the trade receivables was owing from 3 customers). At June 30, 2018, the Company had recorded deferred revenues of $1,841,962 (June 30, 2017 – $217,144)

The share subscription receivables relate to the exercise price for options issued to employees and subsequently exercised. It is recorded as a reduction of share capital.

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 of June 30, 2018, the Company had a cash balance of $2,340,855 (December 31, 2017 - $nil) to settle current liabilities of $5,920,830 (December 31, 2017 - $4,722,736). At June 30, 2018, an amount of $1,152,000 (Euro 750,000) was included in trade payable, representing the remaining payments of the acquisition of a next generation Autonomous Underwater Vehicle (AUV) from the Fraunhofer Institute. Refer to note 2 for discussion of going concern risk.

12. Financial instruments: (continued)

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 June 30, 2018, the Company has cash balances of $2,340,855 and has drawn $Nil against its line of credit. The Company is exposed to interest rate risk on its line of credit balance.

(b) Foreign currency risk

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

The Company's exposure to foreign currency risk was as follows:

	June 30, 2018	December 31, 2017
Financial liabilities denominated in foreign currency:		
Trade and other payables USD	$ 441,342	$ 452,534
Trade and other payables GBP	159,725	202,342
Trade and other payables EUR	870,965	544,026
Financial assets denominated in a foreign currency:		
Trade and other receivables USD	325,346	151,184
Trade and other receivables GBP	-	-
Trade and other receivables, note receivable and investment EUR	135,520	608,406

For the six months ended June 30, 2018, with other variables remaining constant, a 10% increase (decrease) in the exchange rate of the US dollar, British Pound and Euro to Canadian dollar exchange rate would have increased (decreased) the Company's net loss by approximately $282,500 (2017 - $165,000).

Fair Value:

During the six months ended June 30, 2018, 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:

June 30, 2018	Level 1	Level 2	Level 3
Financial assets classified as loans and receivables:			
Cash	$ -	$ 2,340,855	$ -
Trade and other receivables	-	1,049,859	-
Investment tax credits recoverable	-	320,807	-
Note receivable	-	157,571	-
Derivative asset	-	-	7,593
Investment	-	-	30,530
Share subscription receivables	-	76,833	-
Financial liabilities at amortized cost:			
Bank indebtedness	-	-	-
Short term note payable		-	-
Trade and other payables		4,078,868	-

December 31, 2017	**Level 1**	**Level 2**	**Level 3**
Financial assets classified as loans and receivables:			
Trade and other receivables	$ -	$ 1,487,373	$ -
Investment tax credit 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	-

13. Bank indebtedness:

At June 30, 2018, the Company had a $250,000 line of credit for general operating purposes (the “operating line”). The operating line bears interest at the bank’s prime rate plus 2%, payable monthly. As at June 30, 2018, a total of $Nil (December 31, 2017 - $326,448) was drawn against this facility.

In February 2018 the Company entered into a non-revolving term loan facility with Royal Bank Canada backed by a customer contract not yet billed for $750,000. The loan bears Interest at prime plus 2.1% and was paid in full by June 30, 2018.

14. Share capital:

Authorized: Unlimited number of common shares

See the consolidated statements of changes in shareholders’ equity (deficiency) for a summary of changes in Share capital and Contributed surplus for the periods ended June 30, 2018 and 2017

(a) Private Placement

On April 11, 2017, the Company closed a non-brokered private placement of 11,806,660 units (the “Units) at a purchase price of $0.18 per Unit for aggregate gross 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 at $0.30 for a period of 24 months from the date of issuance. The Company paid cash finder’s fee of $12,600 and issued 191,333 finders warrants.

On February 26, 2018, the Company closed a non-brokered private placement of 10,714,285 common shares (the “Shares”) at a price of $0.14 per Share for aggregate gross proceeds of $1,500,000. The Company issued 9,000 finders shares in connection with the offering.

On June 28, 2018 the Company closed a non-brokered private placement of 11,520,000 units (the “Units”) to Ocean Infinity Ltd at a purchase price of $0.20 per Unit for aggregate gross proceeds of $2,304,000. 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 at $0.40 for a period of 36 months from the date of issuance.

(b) Share purchase warrants

On February 18, 2015, as part of the RTO (note 1) the lenders of a $2,109,500 bridge loan to Kraken Robotic Systems Inc. converted the indebtedness into 14,063,326 common shares in the Company. On conversion of the bridge loan,

14. Share capital (continued):

the lenders also received share purchase warrants convertible into the same number of shares exercisable at a price of $0.15 per warrant for a period of thirty-six (36) months from the date of issuance.

Two grants of warrants were issued pursuant to a private placement completed by Anergy in October 2014, prior to completion of the RTO:

i) Each full Warrant A warrant entitled the holder thereof to acquire one common share of the Company at a price of $0.15 after adjusting for the consolidation (or $0.0666666 prior to consolidation). During the year ended December 31, 2016, 58,333 (2015 – 111,111) warrants were exercised for proceeds of $8,750 (2015 - $16,666). The weighted average share price on the dates on which the warrants were exercised during the year was $0.20 (2015 - $0.17). On October 14, 2016, the remaining 275,000 warrants expired unexercised.

ii) Each full Warrant B warrant entitled the holder to acquire one common share at a price of $0.40 after adjusting for the consolidation (or $0.17777777 prior to consolidation). A total of 444,444 warrants expired unexercised on October 14, 2016.

A total of 3,579,767 share purchase warrants were issued in August 2016 upon closing the non-brokered private placement offering.

A further 116,666 share purchase warrants were issued in August 2016 in respect of a debt settlement arrangement.

In April 2017, the Company issued an additional 5,903,330 share purchase warrants in connection with the closing of a non-brokered private placement offering.

In February 2018 2,221,742 warrants were exercised at a price of $0.15 while 11,174,918 warrants expired unexercised.

In June 2018, the Company issued 5,760,000 share purchase warrants in connection with the closing of a non-brokered private placement offering.

Share purchase warrant transactions are summarized for the periods ending June 30, 2018 and December 31, 2017:

	Six months ended June 30, 2018		**Year ended December 31, 2017**	
	Number of Warrants	Weighted Average Exercise Price	Number of Warrants	Weighted Average Exercise Price
Opening balance	22,996,423	$ 0.21	17,759,759	$ 0.18
Issued for private placement	5,760,000	-	5,903,330	0.30
Warrants exercised	(2,221,742)	0.15	(666,666)	0.15
Warrants expired	(11,174,918)	0.15	-	-
Ending balance	15,359,763	$ 0.30	22,996,423	$ 0.21
Warrants exercisable	9,599,763	$ 0.30	22,996,423	$ 0.21

At June 30, 2018 and December 31, 2017, the following share purchase warrants were outstanding:

Expiry Date	**Exercise Price**	**June 30, 2018**	**December 31, 2017**	**Weighted Average Remaining Contractual Life**
February 18, 2018	$0.15	Nil	13,396,660	Nil
August 12, 2018	$0.30	3,579,767	3,579,767	0.12 years
August 22, 2018	$0.30	116,666	116,666	0.14 years
April 11, 2019	$0.30	5,903,330	5,903,330	0.78 years
June 21, 2021	$0.40	5,760,000	-	2.97 years
	$0.21	**15,359,763**	**22,996,423**	**1.44 years**

14. Share capital (continued):

(c) Share options

The Company has a share option plan, under which the Board of Directors is authorized to grant options to employees, directors, officers and consultants, enabling them to acquire up to 10% of the issued and outstanding share capital of the Company. The exercise price of each option is based on the market price of the Company's share as calculated on the date of grant. The options can be granted for a maximum term of five years. Options granted to investor relations consultants are subject to vesting provisions, as established by regulatory authorities, over a twelve-month period, with no more than ¼ vesting during any three-month period. Vesting provisions for other options are determined by the Company's Board of Directors.

The following options were outstanding as at June 30, 2018 and December 31, 2017:

	June 30, 2018		December 31, 2017	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Opening balance	7,130,000	$ 0.18	4,960,000	$ 0.21
Granted	650,000	0.18	2,670,000	0.18
Exercised	Nil	Nil	(100,000)	0.17
Expired	(1,560,000)	0.18	(400,000)	0.25
Ending balance	6,220,000	$ 0.18	7,130,000	$ 0.19
Options exercisable	3,935,827	$ 0.18	4,204,167	$ 0.21

All share options had exercise prices that were higher or equal to market prices at the date of grant.

Weighted Average Exercise Price	Expiry Date	Number Outstanding	Number Exercisable	Weighted Average Remaining Contractual Life
0.21	July 1, 2018	100,000	100,000	0.00 years
0.15	October 12, 2019	600,000	500,000	1.28 years
0.15	December 1, 2019	300,000	200,000	1.42 years
0.17	March 8, 2020	150,000	150,000	1.69 years
0.21	June 1, 2020	2,000,000	2,000,000	1.92 years
0.17	September 8, 2020	350,000	116,667	2.19 years
0.18	October 4, 2020	300,000	100,000	2.27 years
0.18	December 15, 2020	1,770,000	590,000	2.46 years
0.185	February 20, 2021	450,000	112,500	2.65 years
0.21	June 21, 2021	200,000	66,660	1.98 years
$ 0.182		**6,220,000**	**3,935,827**	**1.90 years**

(d) Share-based compensation

During the three-month and six-month period ended June 30, 2018, the Company recorded share-based compensation totaling $85,300 and $114,400 respectively (2017 - $73,600 and $112,600), which was expensed in operations with a corresponding increase in contributed surplus.

The fair value of share options was estimated on the measurement date using the Black-Scholes option-pricing model and is amortized over the vesting period of the underlying options.

14. Share capital (continued):

The fair values of the options granted were estimated using the Black-Scholes option pricing model with the following assumptions:

	Six Months ended June 30, 2018	Six Months ended June 30, 2017
Risk-free interest rate	0.96 to 1.95%	0.61 to 0.96%
Expected life of options	3 years	3 years
Expected volatility	118% to 211%	223 to 229%
Weighted average fair value per option	\$0.11 to \$0.13	\$0.11 to \$0.15
Dividend yield	Nil	Nil

(e) Escrowed shares

At June 30, 2018, there are a total of nil (2017 – 15,294,215) common shares subject to escrow restrictions. The last escrow shares were released on February 18, 2018.

15. 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, and bank indebtedness and short-term note payable. 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.

16. Government assistance:

During the three and six months ended June 30, 2018, the Company received government assistance in the amount of \$320,238 and \$530,456 respectively (2017 - \$253,041 and \$537,715). Government Assistance that was previously reported separately in 2017 and 2016 has been reclassified as a reduction to Cost of Sales, and Research & Development expense. The table below identifies the reclassification for the last 8 quarters.

	Government Assistance (\$)	Cost of Sales (\$)	Research & Development Costs (\$)
Q2 2018	320,238	(106,964)	(213,274)
Q1 2018	210,218	(96,539)	(113,679)
Q4 2017	688,812	(273,693)	(415,119)
Q3 2017	340,413	(114,751)	(225,662)
Q2 2017	253,041	(72,824)	(180,217)
Q1 2017	284,674	(68,593)	(216,081)
Q4 2016	209,875	(80,693)	(129,222)
Q3 2016	109,025	(60,067)	(48,958)

17. Segmented information:

The Company operates in one reportable operating segment, being the design, manufacture and sale of underwater sonar and acoustic sensor equipment. The summarized financial information for revenue derived by geographic segment is as follows:

	Six months ended June 30, 2018	Three months ended June 30, 2018	Six months ended June 30, 2017	Three months ended June 30, 2017
Total revenues:				
Israel	$ -	$ -	$ 271,140	$ 24,642
Italy	78,634	78,634	-	
France	73,968	73,968	-	-
Germany	2,052,019	2,052,019	94,273	94,273
United Kingdom	1,050,779	1,050,779	-	-
United States	471,247	471,247	-	-
Other	-	-	43,002	43,002
	$ 3,726,647	$ 3,726,647	$ 408,415	$ 161,917

18. Commitment:

The following is a summary of the minimum contractual obligations and commitments as at June 30, 2018:

	2018	2019	2020	2021	2022
Operating Leases	$ 187,747	317,800	$ 288,833	$ 208,288	$ 13,970
Research and Development*	231,960	463,920	463,920	463,920	-

*Note: The Company has entered into an agreement with Fraunhofer Institute of Optronic, System Technologies and Image Exploitation ("Fraunhofer IOSB") of Germany whereby it has committed to grant research and development projects to Fraunhofer IOSB of a minimum EUR 300,000 over a period of five years, commencing in 2017. No such grants of research projects have been made to June 30, 2018.

The Company currently has five lease agreements, as follows:

(i) an office lease in Nova Scotia effective September 1, 2018 at a rate of $6,775 including rent and operating costs that expires June 30, 2021

(ii) a production facility lease in Newfoundland and Labrador at a rate of $5,833 per month rent only that expires on May 19, 2019;

(iii) an office lease in Newfoundland at a rate of $13,790 per month including rent and estimated operating costs that expires on January 31, 2022;

(iv) New facility lease Apr 1, 2018 at €2,150 per month including rent and operating, six month commitment that expires month to month following the six month initial term; and

(v) portable modular trailer lease $570 per month rent only expires September 16, 2018.

19. Subsequent events:

Subsequent to June 30, 2018, the Company:

(a) Issued 1,000,000 stock options to employees of Kraken Robotik GmbH (“KRG”), the Company’s fully-owned German subsidiary. These options have a three-year term, vesting in three equal instalments starting on the date of grant and then on the one- and two-year anniversaries of the initial grant. The exercise price on the options is $0.26. This is the first issuance of Kraken options to KRG employees.

(b) Announced that Ocean Infinity has agreed to purchase $9 million of Kraken’s deep-sea batteries with delivery dates expected between Q4 2018 and Q4 2019. Kraken will arrange for these batteries to be built by Kraken Power, an entity in which Kraken currently holds a 19.9% interest. The first purchase order has been issued for $2.5 million and the subsequent purchase order of $6.5 million is expected in early Q1 2019. Kraken is targeting to exercise its right to acquire the additional 55.1% ownership interest in Kraken Power in the second half of 2018. Based on the Ocean Infinity battery contract and other factors, Kraken management is reviewing the extent of the Company’s control over Kraken Power and will determine that impact from consolidating Kraken Power’s financial results before year end.

(c) Received proceeds of $998,350 as a result of the exercise of 3,320,834 previously issued common share purchase warrants and 11,666 finders’ warrants.