# Kraken Robotics Inc.

## Consolidated Financial Statements

**For the years ended December 31, 2019 and 2018**
**(Expressed in Canadian Dollars)**

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# INDEPENDENT AUDITORS' REPORT

To the Shareholders of Kraken Robotics Inc.,

### *Opinion*

We have audited the consolidated financial statements of Kraken Robotics Inc. (the Entity), which comprise:

- the consolidated statements of financial position as at end of December 31, 2019 and end of December 31, 2018
- the consolidated statements of net loss and comprehensive loss for the years then ended
- the consolidated statements of changes in shareholders' equity for the years then ended
- the consolidated statements of cash flows for the years then ended
- and notes to the consolidated financial statements, including a summary of significant accounting policies

(Hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the consolidated financial position of the Entity as at end of December 31, 2019 and December 31, 2018, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRS).

### *Basis for Opinion*

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the "Auditors' Responsibilities for the Audit of the Financial Statements" section of our auditors' report.

We are independent of the Entity in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

### *Other Information*

Management is responsible for the other information. Other information comprises:

- the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions.

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit and remain alert for indications that the other information appears to be materially misstated.

We obtained the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions as at the date of this auditors' report. If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact in the auditors' report.

We have nothing to report in this regard.

***Responsibilities of Management and Those Charged with Governance for the Financial Statements***

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

In preparing the financial statements, management is responsible for assessing the Entity's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Entity or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Entity's financial reporting process.

***Auditors' Responsibilities for the Audit of the Financial Statements***

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

  The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Entity's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Entity to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.
- Provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the group Entity to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

KPMG LLP

Chartered Professional Accountants

The engagement partner on the audit resulting in this auditors' report is James O'Neil.

St. John's, Canada

April 29, 2020

KRAKEN

**December 31, 2019**

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**Consolidated Statements of Financial Position**
**December 31, 2019 and 2018**
**(Expressed in Canadian Dollars)**

| | December 31, 2019 | December 31, 2018 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents (note 5) | **$ 2,097,199** | $ 4,929,865 |
| Trade and other receivables (note 6) | **5,083,740** | 1,733,363 |
| Inventory (note 7) | **5,886,256** | 2,906,669 |
| Prepayments (note 8) | **431,462** | 169,069 |
| | **13,498,657** | 9,738,966 |
| Property and equipment (note 11) | **3,161,924** | 1,817,841 |
| Intangible assets (note 12) | **1,082,945** | 2,099,775 |
| Goodwill (note 12) | **347,350** | 371,883 |
| **TOTAL ASSETS** | **$ 18,090,876** | $ 14,028,465 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| Current Liabilities: | | |
| Trade and other payables | **$ 3,620,443** | $ 1,894,778 |
| Contract liability | **2,445,223** | 2,920,812 |
| Current tax payable | **4,882** | - |
| Current portion of lease liabilities (note 3) | **191,630** | - |
| | **6,262,178** | 4,815,590 |
| Long-term note payable (note 14) | **392,374** | 386,159 |
| Lease liabilities (note 22) | **1,347,006** | - |
| Deferred taxes | **426,000** | 529,281 |
| Shareholders' equity: | | |
| Share capital (note 15) | **22,594,846** | 18,166,572 |
| Contributed surplus | **2,220,924** | 1,774,264 |
| Non-controlling interests (note 9) | **-** | 331,395 |
| Accumulated other comprehensive loss | **(363,031)** | (322,464) |
| Deficit | **(14,789,421)** | (11,652,332) |
| | **9,663,318** | 8,297,435 |
| **TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY** | **$ 18,090,876** | $ 14,028,465 |

Commitments (note 22) Subsequent events (note 24)

**On Behalf of the Board:**

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

The accompanying notes form part of the consolidated financial statements.

**Consolidated Statements of Net Loss and Comprehensive Loss**
**For the Years Ended December 31, 2019 and 2018**
**(Expressed in Canadian Dollars)**

| | 2019 | 2018 |
|---|---|---|
| Product Revenue (note 17) | **$ 14,394,964** | $ 6,471,784 |
| Service Revenue | **751,012** | 236,172 |
| | **15,145,976** | 6,707,956 |
| Cost of sales (note 7) | **8,441,506** | 3,902,538 |
| | **6,704,470** | 2,805,418 |
| Administrative expenses | **5,313,419** | 4,028,757 |
| Research and development costs | **1,886,861** | 2,369,455 |
| Depreciation and Amortization | **1,680,392** | 368,081 |
| Share-based compensation (note 15 (d)) | **1,370,745** | 342,600 |
| Investment tax credits recoverable | **(338,219)** | (320,807) |
| | **9,913,198** | 6,788,086 |
| **Loss from operating activities** | **(3,208,728)** | (3,982,668) |
| Foreign exchange loss | **57,281** | 15,754 |
| Loss (gain) on disposal of assets (note 11) | **(576,425)** | 2,210 |
| Financing costs | **183,073** | 39,992 |
| Loss on change in control payment (note 9) | **174,996** | - |
| Gain on previously held equity interest on acquisition (note 9) | **-** | (1,076,530) |
| **Net loss before taxes** | **(3,047,653)** | (2,964,094) |
| Income tax – Current (note 20) | **17,218** | - |
| Income tax – Deferred (note 20) | **(61,385)** | (111,705) |
| **Net loss** | **(3,003,486)** | (2,852,389) |
| **Net income (loss) attributed to:** | | |
| Shareholders of Kraken Robotics Inc. | **(3,430,121)** | (2,716,501) |
| Non-controlling interests | **426,635** | (135,888) |
| | **$(3,003,486)** | $(2,852,389) |
| Basic and diluted (loss) income per share | **$ (0.02)** | $ (0.03) |
| Basic and diluted weighted average number of shares outstanding | **147,117,186** | 110,696,271 |

**Consolidated Statements of Net Loss and Comprehensive Loss**
**For the Years Ended December 31, 2019 and 2018**
**(Expressed in Canadian Dollars)**

| | **2019** | **2018** |
|---|---|---|
| Net loss | **$(3,003,486)** | $(2,852,389) |
| Other comprehensive loss | | |
| *Items that may be reclassified to profit or loss* | | |
| Currency translation adjustment | **(40,567)** | (67,951) |
| **Other comprehensive loss** | **(40,567)** | (67,951) |
| **Comprehensive loss** | **$(3,044,053)** | $(2,920,340) |
| **Comprehensive loss attributed to:** | | |
| Shareholders of Kraken Robotics Inc. | **(3,460,546)** | (2,767,464) |
| Non-controlling interests | **416,493** | (152,876) |
| **Other comprehensive loss** | **$(3,044,053)** | $(2,920,340) |

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## Consolidated Statements of Changes in Shareholders' Equity
## For the Years Ended December 31, 2019 and 2018
## (Expressed in Canadian Dollars)

| 2019 | Number of Shares | Share capital (note 14) | Contributed Surplus | Accumulated other comprehensive loss | Non-Controlling Interest | Deficit | Total |
|---|---|---|---|---|---|---|---|
| Balance at December 31, 2018 | **137,025,820** | **$ 18,166,572** | **$ 1,774,264** | **$ (322,464)** | **331,395** | **$ (11,652,332)** | **8,297,435** |
| Adjustment to deficit – change in accounting policy (note 3) | | | | | | **48,932** | **48,932** |
| Balance at January 1, 2019 | **137,025,820** | **18,166,572** | **1,774,264** | **(322,464)** | **331,395** | **(11,603,400)** | **8,346,367** |
| Net profit (loss) | **-** | **-** | **-** | **-** | **426,635** | **(3,430,121)** | **(3,003,486)** |
| Other comprehensive loss | | | | **(30,425)** | **(10,142)** | | **(40,567)** |
| Transactions with shareholders, recorded directly in equity: | | | | | | | |
| Issue of common shares on stock option exercises | **1,025,666** | **270,331** | **(112,711)** | - | | **-** | **157,620** |
| Issue of common shares on warrant exercises | **8,889,442** | **4,052,807** | **(811,374)** | - | | **-** | **3,241,433** |
| Issue of common shares on acquisition of non-controlling interest (note 9) | **236,258** | **146,480** | | - | **(146,480)** | **-** | **-** |
| Cash payment on acquisition of non-controlling interest (note 9) | | | | | **(367,450)** | | **(367,450)** |
| Reclassifications following acquisition of non-controlling interest (note 9) | | | | **(10,142)** | **(233,958)** | **244,100** | **-** |
| Share issue costs | - | **(41,344)** | - | - | | **-** | **(41,344)** |
| Share-based compensation | - | **-** | **1,370,745** | - | | **-** | **1,370,745** |
| **Shareholders' equity as at December 31, 2019** | **147,177,186** | **$ 22,594,846** | **$ 2,220,924** | **$ (363,031)** | **-** | **$ (14,789,421)** | **$9,663,318** |

| 2018 | Number of Shares | Share capital (note 14) | Contributed Surplus | Accumulated other comprehensive loss | Non-Controlling Interest | Deficit | Total |
|---|---|---|---|---|---|---|---|
| Balance at January 1, 2018 | **90,992,740** | **$ 6,008,347** | **$ 2,157,803** | **$ (271,501)** | **$ -** | **$ (8,935,831)** | **$ (1,041,182)** |
| Net loss | - | - | - | - | (135,888) | (2,716,501) | (2,852,389) |
| Other comprehensive loss | | | | (50,963) | (16,988) | | (67,951) |
| Non-Controlling interest (note 9) | | | | | 484,271 | | 484,271 |
| 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 stock option exercises | 363,333 | 63,600 | (14,700) | - | | - | 48,900 |
| Issue of common shares on warrant exercises | 8,426,462 | 2,652,924 | (459,647) | - | | - | 2,193,277 |
| Issue of common shares on Bought Deal | 15,000,000 | 5,921,900 | 78,100 | - | | - | 6,000,000 |
| Issue of common shares as Finder's Fee | 9,000 | 1,260 | - | - | | - | 1,260 |
| Expiry of Warrants | | 990,992 | (990,992) | - | | - | - |
| Share issue costs | - | (615,351) | - | - | | - | (615,351) |
| Share-based compensation | - | - | 342,600 | - | | - | 342,600 |
| **Shareholders' equity as at December 31, 2018** | **137,025,820** | **$ 18,166,572** | **$ 1,774,264** | **$ (322,464)** | **331,395** | **$ (11,652,332)** | **8,297,435** |

The accompanying notes form part of the consolidated financial statements.

| | 2019 | 2018 |
|---|---|---|
| **Cash flows used in operating activities** | | |
| Net loss | **$ (3,003,486)** | $ (2,852,389) |
| **Adjustments for items not involving cash:** | | |
| Depreciation | **767,185** | 279,642 |
| Amortization of intangible assets | **913,207** | 282,089 |
| Share-based payments | **1,370,745** | 342,600 |
| Loss (Gain) on disposal of property, plant and equipment | **(576,425)** | 2,169 |
| Unrealized foreign exchange loss (gain) | **85,167** | (65,709) |
| Interest on lease liability (note 22) | **178,118** | - |
| Accretion of long-term note payable (note 14) | **31,690** | - |
| Deferred tax recovery | **(61,385)** | (111,705) |
| Loss on change in control payment (note 9) | **174,996** | - |
| Gain on previously held equity interest on acquisition (note 9) | **-** | (1,076,531) |
| Changes in non-cash working capital (note 21) | **(4,807,385)** | (3,305,682) |
| **Net cash flows used in operating activities** | **(4,927,573)** | (6,505,516) |
| **Cash flows from (used in) investing activities** | | |
| Proceeds on disposal of property and equipment (note 11) | **995,930** | - |
| Purchase of property and equipment | **(1,643,065)** | (269,581) |
| Cash paid on acquisition of non-controlling interest (note 9) | **(367,450)** | - |
| Net cash acquired (paid) on acquisition of Kraken Power (note 9) | **-** | 599,324 |
| | **(1,014,585)** | 329,743 |
| **Cash flows from (used in) financing activities** | | |
| Proceeds from equity offerings | **157,620** | 9,805,260 |
| Proceeds from exercise of warrants and options | **3,241,433** | 2,242,177 |
| Share issue costs | **(41,344)** | (615,351) |
| Payments on lease liability (note 22) | **(248,217)** | |
| Increase (decrease) in bank indebtedness | **-** | (326,448) |
| | **3,109,492** | 11,105,638 |
| **Net increase (decrease) in cash and cash equivalents** | **(2,832,666)** | 4,929,865 |
| **Cash and cash equivalents at beginning of year** | **4,929,865** | - |
| | **-** | - |
| **Cash and cash equivalents at end of year** | **$ 2,097,199** | $ 4,929,865 |

**1. Corporate Information:**

Kraken Robotics Inc. ("Kraken" or the "Company") was incorporated on May 14, 2008 under the *Business Corporations Act, British Columbia*), is a publicly traded company, and has its registered office 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. Basis of presentation:**

(a) Statement of compliance:

These consolidated financial statements, including comparatives, have been prepared in accordance with International Financial Reporting Standards ("IFRS") and Interpretations by the International Financial Reporting Interpretations Committee ("IFRIC").

These consolidated financial statements were approved by the Board of Directors on April 29, 2020.

(b) Basis of measurement and reclassification of comparative figures:

These consolidated financial statements have been prepared on a historical cost basis.

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

(c) Basis of Consolidation

These consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its wholly owned subsidiaries), Kraken Robotic Systems Inc., Ocean Discovery Inc., Kraken Robotik GmbH, Kraken Power GmbH. All intercompany balances and revenue and expense transactions have been eliminated on consolidation.

(d) Accounting estimates and judgments:

The preparation of consolidated financial statements in accordance with IFRS requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and may have an impact on future periods. The more significant areas requiring the use of management estimates and judgments are discussed below:

i) Estimates of useful lives of property and equipment

Useful lives and residual value of property and equipment are reviewed by management on a regular basis to ensure assumptions are still valid. Property and equipment is reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be fully recoverable. If an asset's recoverable amount is less than the asset's carrying amount, an impairment loss is recognized.

Any changes in estimates would impact the economic useful lives and the residual values of the assets and, therefore, future depreciation charges could be revised.

ii) Recovery of deferred tax assets

Deferred tax assets, including those arising from tax loss carry-forwards, capital losses and temporary differences are recognized only where it is considered probable that they will be recovered, which is dependent

**2. Basis of presentation (continued):**

on the generation of sufficient future taxable profits. Assumptions about the generation of future taxable profits depend on management's estimates of future cash flows.

Judgments are also required about the application of income tax legislation. These judgments and assumptions are subject to risk and uncertainty, hence there is a possibility that changes in circumstances will alter expectations, which may impact the amount of deferred tax assets and deferred tax liabilities recognized on the statement of financial position and the amount of other tax losses and temporary differences not yet recognized. In such circumstances, some or all of the carrying amounts of recognized deferred tax assets and liabilities may require adjustment, resulting in a corresponding credit or charge to the statement of net income (loss) and comprehensive income (loss).

iii) Share-based payments

The amounts recorded for share-based compensation are based on estimates. The Black Scholes model is used to estimate the fair value of stock options at the date of grant based on estimates of assumptions for share price, expected volatility, expected number of options to vest, dividend yield, risk-free interest rate, expected forfeitures and expected life of the options. Changes in these assumptions may result in a material change to the amounts recorded for the issuance of stock options.

iv) Business Combinations

The Company recognizes the consideration paid, assets acquired and liabilities assumed at their acquisition date fair values, recognizing any goodwill acquired or gain on purchase. The purchase price allocation requires significant judgements in the identification of the acquired assets and assumed liabilities. To determine the fair values of the identified assets and liabilities the Company will use the discounted cash flow method and other accepted valuation techniques that require assumptions about business strategies, growth rates, operating costs, discount rates and other economic factors.

The Company's assessment that it has control over an entity when it owns less than 50% of ownership interest requires significant judgement and consideration of 'de-facto' control. De-facto control exists when the size of the Company's own voting rights relative to the size and dispersion of other vote holders give the Company the ability to direct the relevant activities of the entity. In other cases, the assessment of control may be more complex and require more than one factor to be considered, for example when power results from one or more contractual arrangements. An investor with the current ability to direct the relevant activities has power even if its rights to direct have yet to be exercised. Evidence that the investor has been directing relevant activities can help determine whether the investor has power, but such evidence is not, in itself, conclusive in determining whether the investor has power over an investee.

For business combinations, the acquisition date is generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree. However, acquisition date may differ from this date if the Company obtains control on a date that is either earlier or later than this date. For example, the acquisition date precedes the closing date if a written agreement provides that the Company obtains control of the acquiree on a date before the closing date. The Company considers all pertinent facts and circumstances in identifying the acquisition date.

**2. Basis of presentation (continued):**

iv) Goodwill and intangible assets

The Company conducts impairment testing on its goodwill and intangible assets annually in the fourth quarter and whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The Company determines the fair value of each cash-generating unit to which goodwill and intangible assets are allocated using the value in-use-method, which estimates fair value using a discounted five-year forecasted cash flow estimate with a terminal value. The determination of the recoverable amount involves estimates and assumptions of future revenues, product margins, market conditions, and appropriate discount rates.

**3. Adoption of new accounting pronouncements:**

***IFRS 16, Leases***

IFRS 16 supersedes IAS 17 Leases, IFRIC 4 *Determining whether an Arrangement contains a Lease*, and other related Standard Interpretations Committee ("SIC") interpretations. The standard sets out the principles for the recognition, measurement, presentation and disclosure of leases and require lessees to account for most leases under a single on-balance sheet model.

On adoption of IFRS 16, the Company recognized a lease liability in relation to property leases which had previously been classified as 'operating leases' under the principal of IAS 17. As of January 1, 2019, these liabilities were measured at the present value of the remaining lease payments discounted at 12%, which reflects the lessee's incremental borrowing rate to finance the purchase of similar property. The Company has applied IFRS 16 using the modified retrospective approach, whereby the cumulative effect of adopting IFRS 16, is recognized as an adjustment to opening retained earnings as at January 1, 2019, with no restatement of comparative information. Under this method using the practical expedients available, the Company has recognized the right of use asset equal to the lease liability.

The lease liabilities as at January 1, 2019 can be reconciled to the operating lease commitments as of December 31, 2018 as follows:

| | |
|---|---|
| Operating lease commitments disclosed as at December 31, 2018 | 1,507,528 |
| Less: Short-term leases not included in lease liability | (79,909) |
| Balance | 1,427,619 |
| Incremental borrowing rate as at January 1, 2019 | 12% |
| **Discounted operating lease commitments at January 1, 2019** | **1,265,045** |
| Add: | |
| Finance lease liabilities recognized as at date of initial application | 252,995 |
| **Lease liability recognized as at January 1, 2019** | 1,518,040 |

The additional $252,995 of finance lease liabilities recognized represent lease payments arising from lease extension options for which the Company has no contractual commitment to exercise, but is reasonably certain to do so.

The right-of-use assets associated with these property leases were initially measured at the amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to those leases recognized in the consolidated statement of financial position as at December 31, 2018.

**3. Adoption of new accounting pronouncements (continued):**

**Practical expedients applied**

In applying IFRS 16 for the first time, the Company has used the following practical expedients permitted by the Standard:

- the use of a single discount rate to a portfolio of leases with reasonably similar characteristics;
- reliance on previous assessments on whether leases are onerous;
- the accounting for operating leases with a remaining lease term of less than 12 months as at January 1, 2019 **3. Adoption of new accounting pronouncements (continued):** as short-term leases; and
- the use of hindsight in determining the lease term where the contract contains options to extend or terminate the lease

The Company has also elected not to reassess whether a contract is, or contains a lease at the date of initial application. Instead, for contracts entered into before the transition date the Company relied on its assessments previously made in applying IAS 17 and IFRIC 4.

Based on the foregoing, as at January 1, 2019:

- Right-of-use assets of $1,518,040 were recognized and presented within property and equipment in the consolidated statement of financial position.
- Lease liabilities of $1,518,040 were recognized and presented separately in the consolidated statement of financial position.
- Lease inducements of $ 48,932 related to previous operating leases were derecognized. The impact of this adjustment was recorded as a transition adjustment to opening retained earnings.

**Summary of new accounting policies**

The Company has adopted the following new accounting policies upon implementation of IFRS 16 on January 1, 2019:

*Right-of-use assets*

The Company recognizes right-of-use assets at the commencement date of the lease (i.e. the date the underlying asset is available for use). Right-of-use assets are measured at cost, less any accumulated depreciation and impairment losses, and adjusted for any re-measurement of lease liabilities. The cost of right-of-use assets includes the amount of lease liabilities recognized, initial direct cost incurred, and lease payments made at or before the commencement date less any lease incentives received. The right-of-use assets are depreciated on a straight-line basis over its lease term. Right-of-use assets are subject to evaluation of potential impairment.

*Lease liabilities*

At the commencement date of the lease, the Company recognizes lease liabilities measured at the present value of lease payments to be made over the lease term. The lease payments include fixed payments (including in-substance fixed payments).

**3. Adoption of new accounting pronouncements (continued):**

The lease payments also include the exercise price of purchase options, if any, reasonably certain to be exercised by the Company and payments of penalties for terminating a lease, if the lease term reflects the Company exercising the option to terminate. The variable lease payment that do not depend on an index or a rate are recognized as expense in the period on which the event or condition that triggers the payment occurs.

In calculating the present value of lease payments, the Company uses the incremental borrowing rate at the lease commencement date if the interest rate implicit in the lease is not readily determinable. After the commencement date, the amount of lease liabilities is increased to reflect the accretion of interest and reduced for the lease payments made. In addition, the carrying amount of lease liabilities is re-measured if there is a modification, a change in the lease term or a change in the in-substance fixed lease payments.

*Short-term leases and leases of low-value assets*

The Company applies the short-term lease recognition exemption to its short-term leases of properties (i.e., those leases that have a lease term of 12 months or less from the commencement date and do not contain a purchase option). It also applies the lease of low-value assets recognition exemption to leases of office equipment that are considered of low value (i.e., below $5,000). Lease payments on short-term leases and leases of low-value assets are recognized as expense on a straight-line basis over the lease term.

**Summary of new significant judgements**

*Determining the lease term of contracts with renewal options*
The Company determines the lease term as the non-cancellable term of the lease, together with any periods covered by an option to extend the lease if it is reasonably certain to be exercised, or any periods covered by an option to terminate the lease, if it is reasonably certain not to be exercised.

The Company has the option, under some of its leases to lease the assets for additional terms of one to ten years. The Company applies judgement in evaluating whether it is reasonably certain to exercise the option to renew, including the consideration of all relevant factors that create an economic incentive to exercise the renewal option. After the commencement date, the Company reassesses the lease term if there is a significant event or change in circumstances that is within its control and affects its ability to exercise the option to renew. The Company included the renewal period as part of the lease term for substantially all of its property leases due to the significance of these assets to its operations.

**New accounting standards not yet adopted**

The IASB issued the following standards that has not been applied in preparing these consolidated financial statements as their effective date falls within annual periods beginning subsequent to the current reporting period.

*IAS 1 – Presentation of Financial Statements and IAS 8 – Accounting Policies, Changes in Estimates and Errors*

On October 31, 2018, the IASB issued amendments to IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. These amendments clarify the definition of 'material' and aligns the definition used within the IFRS Standards. The effective date of the amendment is for annual periods beginning on or after January 1, 2020 and is to be applied prospectively.

The application of this amendment is not expected to have a material impact to the Company.

## 3. Adoption of new accounting pronouncements (continued):

*IFRS 3 – Business Combinations*

On October 22, 2018 the IASB issued an amendment to IFRS 3 *Business Combinations* to narrow the definition of a business and introduce a screening test, which eliminates the requirement for a detailed assessment of the definition, when met. The effective date of the amendment is for annual periods beginning on or after January 1, 2020 and is to be applied prospectively.

The application of this amendment is not expected to have a material impact to the Company.

## 4. Significant accounting policies

(a) Business combinations:

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred at acquisition date fair value. The acquired identifiable assets and assumed liabilities are measured at their fair value at the date of acquisition. Any excess of the consideration transferred over the fair value of the net assets acquired is recognized as goodwill. Any deficiency of the consideration transferred below the fair value of the net assets acquired is recorded as a gain in net income. Associated transaction costs are expensed when incurred.

(b) Government grants:

Government grants are initially recognized as deferred income at fair value if there is reasonable assurance that they will be received and the Company will comply with the conditions associated with the grant; they are netted against the cost of the associated assets.

Grants that compensate the Company for expenses incurred are recognized in profit or loss, by way of a reduction of the corresponding expenses, on a systematic basis in the periods in which the expenses are recognized.

(c) Foreign currency transactions:

In preparing the financial statements of each individual corporate entity, transactions in foreign currencies other than the Company's functional currency (foreign currencies) are recognized at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences on monetary items are generally recognized in profit or loss in the period in which they arise.

(c) Foreign currency translations:

These consolidated financial statements are presented in Canadian dollars. The results and financial position of all the Company's entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- shareholders' equity is translated at historical rates of exchange;
- intercompany loans are translated at historical rates of exchange as they are considered part of the net investment in foreign subsidiaries and for which settlement is neither planned nor likely to occur in the foreseeable future;
- other assets and liabilities are translated at the closing rate at the date of the statement of financial position;

**4. Significant accounting policies (continued):**

- income and expenses for each income statement presented are translated at monthly average exchange rates; and
- all resulting exchange differences are recognized within Accumulated Other Comprehensive Income ("AOCI") which is a separate component of equity.

(d) Income tax:

Income tax expense is comprised of current and deferred income tax. Current tax and deferred income tax are recognized in profit or loss except to the extent that they relate to a business combination, or items recognized directly in equity or in other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years. Taxable earnings differs from earnings as reported in the consolidated financial statements because of items of income or expense that are taxable or deductible in years other than the current reporting period or items that are never taxable or deductible.

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for the temporary differences relating to investments in subsidiaries and joint venture to the extent that it is probable that they will not reverse in the foreseeable future. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

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

(e) Inventories:

Inventories are recorded at the lower of cost and net realizable value. Cost is determined on a first-in, first-out basis.

(f) Property and equipment and Intangibles:

All items of property and equipment are measured at historical cost less accumulated depreciation and accumulated impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing of property and equipment are recognized in profit or loss as incurred.

Depreciation is calculated using estimation to allocate their cost, net of estimated residual values, over their estimated useful lives using the following methods and at the following annual rates:

**4. Significant accounting policies (continued):**

| Asset | Basis | Rate |
|---|---|---|
| Computer equipment | Declining balance | 50% |
| Leasehold improvements | Straight-line | 20% |
| Autonomous underwater vehicle | Straight-line | 12.5% |
| Computer software | Straight-line | 20% |
| Furniture and fixtures | Declining balance | 20% |
| Tools and equipment | Straight-line | 10% |

Depreciation methods, useful lives and residual values are reviewed at each financial year end and adjusted prospectively, if appropriate.

Goodwill and intangible assets:

(i) Recognition and measurement

Goodwill and intangible assets with indefinite lives arising on the acquisition of subsidiaries are measure at cost less accumulated impairment losses.

Intangible assets, including trademarks and trade names, technology and trade secrets, customer contracts and customer relationships that are acquired and have finite useful lives are measure at cost less accumulated amortization and any accumulated impairment losses.

(ii) Subsequent expenditures

Subsequent expenditures are capitalized only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in profit or loss as incurred.

(iii) Amortization

Amortization is calculated to write-off the cost of intangible assets less their estimated residual values using the straight-line method over their estimated useful lives and is recognized in profit or loss. Goodwill and trademarks and trade names with indefinite lives are not amortized.

The estimated useful lives of finite lived intangible assets are as follows:

| Asset | Period |
|---|---|
| Technology and trade secrets | 5 years |
| Customer contracts | 1 year |
| Customer relationships | 6 years |

Amortization methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

**4. Significant accounting policies (continued):**

(g) Research and development:

Research costs are expensed as incurred. Development costs are capitalized only if the expenditure can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable and the Company intends to and has sufficient resources to complete development and to use or sell the asset. Otherwise, such costs are expensed as incurred. Subsequent to initial recognition, development costs are measured at cost less accumulated amortization and any accumulated impairment losses. To date, no development costs have been capitalized.

(h) Financial instruments

(i) Financial assets and liabilities

*Initial measurement and classification*

A financial asset (unless it is a trade receivable without a significant financing component) or financial liability is initially measured at fair value plus transaction costs that are directly attributable to its acquisition or issue. A trade receivable without a significant financing component is initially measured at the transaction price.

Trade receivables are initially recognized when they originate. All other financial assets and financial liabilities are initially recognized when the Company becomes a party to the contractual provisions of the instrument.

On initial recognition, a financial asset is classified as measured at amortized cost or Fair Value Through Profit and Loss (“FVTPL”) while a debt instrument is recognized at Fair Value Through Other Comprehensive Income (“FVOCI”) or FVTPL.

A financial asset is measured at amortized cost if it meets both of the following conditions and is not designated as at FVTPL:

- it is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

A debt instrument is measured at FVOCI if it meets both of the following conditions and is not designated as at FVTPL:

- it is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Financial liabilities are classified as measured at amortized cost or FVTPL. A financial liability is classified as at FVTPL if

it is classified as held-for-trading, it is a derivative or if it is designated as such on initial recognition. Financial liabilities at FVTPL are measured at fair value and net gains and losses, including any interest expense, are recognized in profit or loss.

The Company derecognizes a financial liability when its contractual obligations are discharged or cancelled. The Company also derecognizes a financial liability when its terms are modified and the cash flows of the modified liability are substantially different, in which case a new financial liability based on the modified terms is recognized at fair value. On derecognition of a financial liability, the difference between the carrying amount extinguished and the consideration paid (including any non-cash assets transferred or liabilities assumed) is recognized in profit or loss.

**4. Significant accounting policies (continued):**

*Subsequent measurement*

| | |
|---|---|
| Financial assets at FVTPL | These assets, except derivatives designated as hedging instruments, are subsequently measured at fair value. Net gains and losses, including any interest or dividend income, are recognized in profit or loss. |
| Financial assets at amortized cost | These assets are subsequently measured at amortized cost using the effective interest method. The amortized cost is reduced by impairment losses. Interest income, foreign exchange gains and losses and impairment are recognized in profit or loss. Any gain or loss on derecognition is recognized in profit or loss. |
| Financial liabilities at amortized cost | These financial liabilities are subsequently measured at amortized cost using the effective interest method. Interest expense and foreign exchange gains and losses are recognized in profit or loss. Any gain or loss on derecognition is also recognized in profit or loss. |
| Debt instruments at FVOCI | These instruments are subsequently measured at fair value. Interest income calculated using the effective interest method, foreign exchange gains and losses and impairment are recognised in profit or loss. Other net gains and losses are recognised in OCI. On derecognition, gains and losses accumulated in OCI are reclassified to profit or loss. |

The Company's financial assets include cash and cash equivalents and trade and other receivables. The Company's financial liabilities include trade and other payable, and long-term note payable. Classification of these financial instruments is as follows:

| **Financial instrument** | **Current classification** |
|---|---|
| Cash and cash equivalents | Financial asset at amortized cost |
| Trade and other receivables | Financial asset at amortized cost |
| Note receivable | Financial assets at FVTPL |
| Derivative asset | Financial assets at FVTPL |
| Investments | Financial assets at FVTPL |
| Bank indebtedness | Financial asset at amortized cost |
| Trade and other payables | Financial asset at amortized cost |

(ii) Fair value measurement:

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value hierarchy establishes three levels to classify the inputs to valuation techniques used to measure fair value.

Level 1: Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.

**4. Significant accounting policies (continued):**

Level 2: Inputs are quoted prices in markets that are not active, quoted prices for similar assets or liabilities in active markets, inputs other than quoted prices that are observable for the asset or liability (for example, interest rate and yield curves observable at commonly quoted intervals, forward pricing curves used to value currency and commodity contracts, volatility measurements used to value option contracts and observable credit default swap spreads to adjust for credit risk where appropriate), or inputs that are derived principally from or corroborated by observable market data or other means.

Level 3: Inputs are unobservable (supported by little or no market activity).

The fair value hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3 inputs.

*Impairment of financial assets*

The Company recognizes loss allowances for Expected Credit Losses (ECLs) on financial assets measured at amortized cost. The Company measures loss allowances at an amount equal to the lifetime ECLs in accordance with the 'simplified approach' available under the standard. Under this approach, loss allowances on trade accounts receivable are always measured at lifetime ECLs.

When determining whether the credit risk of a financial asset has increased significantly since initial recognition and when estimating ECLs, the Company considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Company's historical experience and informed credit assessment and includes forward-looking information.

The Company assumes that the credit risk on financial assets has increased if it is more than 30 days past due. The Company considers a financial asset to have low credit risk when its credit risk rating is equivalent to the globally understood definition of 'investment grade'.

(i) Impairment:

The carrying amounts of the Company's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indications exist, the asset's recoverable amount is estimated.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets are grouped together into the smallest group of assets which generates cash inflows from continuing use that is largely independent of the cash inflows of other assets or groups of assets (the "cash-generating-unit" or "CGU").

(k) Earnings (loss) per share:

The Company presents basic and diluted earnings (loss) per share for its common shares. Basic earnings (loss) per share is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of shares outstanding adjusted for the effects of all dilutive potential common shares.

## 5. Cash and cash equivalents

Cash and cash equivalents consist of the following:

| | 2019 | 2018 |
|---|---|---|
| Cash | $ 1,329,949 | $ 2,929,865 |
| Short term Investments | 767,250 | 2,000,000 |
| | $ 2,097,199 | $ 4,929,865 |

As at December 31, 2019, the Company had in cash equivalents $767,250 (2018 - $2,000,000) in Guaranteed Investment Certificates, interest rate 1.75% per annum, 30 day non-cashable period, and 12 month maturity.

## 6. Trade and other receivables:

Trade and other receivables consist of the following:

| | 2019 | 2018 |
|---|---|---|
| Trade receivables | $ 3,236,207 | $ 987,415 |
| Contract Asset | 272,832 | 284,352 |
| Government assistance receivable and other | 1,574,701 | 461,596 |
| | $ 5,083,740 | $ 1,733,363 |

## 7. Inventory

As at December 31, 2019, the Company held $5,886,256 (2018 - $2,906,669) in inventory**,** consisting of $4,660,148 (2018 - $1,498,827) in raw materials and $1,226,108 (2018 - $1,407,842) in work-in-progress. Included in cost of sales is inventory of $7,335,900 (2018 - $3,240,665). Inventory write-downs consisted of $557 (2018 - $51,757).

## 8. Prepayments

As at December 31, 2019, the Company had made prepayments of $431,462 (2018 - $169,069). Prepayments towards inventory were $328,664 which included an amount of $239,300 paid to one vendor.

## 9. Acquisition of Kraken Power

During the second quarter of 2017, the Company acquired a minority interest in ENITECH Subsea GmbH of Rostock, Germany which was renamed Kraken Power GmbH. Under the agreement, Kraken took a 19.9% equity interest for €20,520 ($30,530) and provided a €110,000 (CAD $168,960) 5% convertible loan. Through the conversion of the loan to equity and a further investment capped at €200,000, the Company could acquire a further 55.1% equity interest, for an aggregate 75% ownership stake position, in Kraken Power GmbH.

During the third quarter of 2018, the Company acquired a significant contract with a customer in which Kraken Power was subcontracted to complete the work. On issuing the purchase order to Kraken Power and transferring initial funds to finance the contract on August 14, 2018, the Company determined that it had the practical ability to direct the relevant activities of Kraken Power and has consolidated Kraken Power with a 25% non-controlling interest, effective August 14, 2018.

The following table reflects the acquisition accounting and the fair value of the net assets acquired at the acquisition date:

### 9. Acquisition of Kraken Power (continued):

| **Net Assets Acquired** | | **Euros €** | | **Canadian $** |
|---|---|---|---|---|
| Cash | € | 399,017 | $ | 599,324 |
| Accounts Receivable | | 206,873 | | 310,723 |
| Inventory | | 685,458 | | 1,029,558 |
| Prepaids and other | | 87,737 | | 131,781 |
| Fixed Assets | | 149,499 | | 224,548 |
| Intangible assets | | 1,582,000 | | 2,376,166 |
| Goodwill | | 238,188 | | 357,759 |
| Trade payables & other liabilities | | (1,399,772) | | (2,102,459) |
| Long-term debt | | (247,332) | | (371,493) |
| Deferred tax liability | | (412,000) | | (618,824) |
| **Net Assets** | **€** | **1,289,668** | **$** | **1,937,083** |
| Less: Minority interest | | (322,417) | | (484,271) |
| Less: Excess fair value of net assets acquired over consideration paid | | (716,731) | | (1,076,531) |
| **Net Assets Acquired** | **€** | **250,520** | **$** | **376,281** |

| **Consideration** | | **Euros €** | | **Canadian $** |
|---|---|---|---|---|
| Cash paid to date for 19.9% | € | 20,520 | $ | 30,821 |
| Convertible Loan and accrued interest | € | 118,800 | $ | 178,438 |
| Amount Payable | € | 111,200 | $ | 167,022 |
| **Total Consideration** | **€** | **250,520** | **$** | **376,281** |

On December 31, 2019 Kraken acquired the remaining 25% of Kraken Power not currently owned for €350,000, consisting of €250,000 ($367,450) in cash and the issuance of 236,258 common shares of the Company at $0.62 per share ($146,480). The shares issued have a four-month statutory hold period commencing on the date of issuance. The transaction triggered a change of control payment to an arm's length third-party lender to Kraken Power in an amount equal to €120,000 ($174,996) payable in two tranches of €60,000 over calendar 2020 for which Kraken will be responsible.

### 10. 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:

| | | **December 31, 2019** | | **December 31, 2018** |
|---|---|---|---|---|
| Cash and cash equivalents | $ | 2,097,199 | $ | 4,929,865 |
| Trade and other receivables | | 5,083,740 | | 1,733,363 |
| | $ | 7,180,939 | $ | 6,663,228 |

**10. Financial instruments (continued):**

The Company's trade receivables have been aged as follows:

| | December 31, 2019 | December 31, 2018 |
|---|---|---|
| Current | $ 1,631,029 | $ 918,575 |
| 31-60 days | 550,102 | 35,381 |
| 61-90 days | 880,838 | 32,684 |
| > 90 days | 174,238 | 775 |
| | $ 3,236,207 | $ 987,415 |

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.

Revenues from the top 3 customers represented 90% of the Company's revenue in the year ended December 31, 2019 (2018– top 3 customers represented 72%). At December 31, 2019, 66% of the trade receivables balance were owing from 2 customers (2018 – 58% of the trade receivables was owing from 2 customers). At December 31, 2019, the Company had recorded contract liabilities of $2,445,223 (2018 – $2,920,812).

**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 December 31, 2019, the Company had a cash and cash equivalents balance of $2,097,199 (December 31, 2018 - $4,929,865) to settle current liabilities of $6,278,886 (December 31, 2018 - $4,815,590) of which contract liabilities make up $2,445,223 (December 31, 2018 - $2,920,812).

The following are the contractual maturities of financial liabilities based on the earliest date on which the Company can be required to repay such liabilities:

| | Less than one year | Beyond one year |
|---|---|---|
| Trade and other payables | $ 3,445,447 | $ - |
| Change in control payable | 174,996 | |
| Long-term note payable | 50,500 | 707,745 |
| Lease liabilities | $191,630 | $1,347,006 |
| | $ 3,862,573 | $ 2,054,751 |

**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, 2019, the Company held $2,097,199 in cash and cash equivalents and has drawn $Nil against its line of credit. The operating line bears interest at the bank's prime rate plus 2.5%, payable monthly.

## 10. Financial instruments (continued):

(b) Foreign currency risk

The Company's exposure to foreign currency risk is limited to sales in USD, EUR, and GBP, certain purchases of inventory in USD, EUR and GBP. 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:

| | December 31, 2019 | December 31, 2018 |
|---|---|---|
| Financial liabilities denominated in foreign currency: | | |
| Trade and other payables USD | $ 62,577 | $ 103,648 |
| Trade and other payables GBP | 3,900 | 16,000 |
| Trade and other payables EUR | 814,618 | 329,185 |
| Long-term debt EUR | 269,063 | 247,332 |
| Financial assets denominated in a foreign currency: | | |
| Trade and other receivables USD | 2,027,589 | 566,575 |
| Trade and other receivables GBP | - | - |
| Trade and other receivables EUR | 397,646 | 106,502 |

For the year ended December 31, 2019, with other variables remaining constant, a 10% increase (decrease) in the exchange rate of the US dollar, British Pound and Euro to the Canadian dollar exchange rate would have increased (decreased) the Company's net loss by approximately $154,616 (2018 - $200,780).

**Fair Value:**

During the year ended December 31, 2019, 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, 2019 | Level 1 | Level 2 | Level 3 |
|---|---|---|---|
| Financial assets at amortized cost: | | | |
| Cash and cash equivalents | $ 2,097,199 | $ - | $ - |
| Trade and other receivables | - | 5,083,740 | - |
| Financial liabilities at amortized cost: | | | |
| Trade and other payables | - | 3,620,443 | - |
| Long-term note payable | - | 392,374 | - |

| December 31, 2018 | Level 1 | Level 2 | Level 3 |
|---|---|---|---|
| Financial assets at amortized cost: | | | |
| Cash and cash equivalents | $ 4,929,865 | $ - | $ - |
| Trade and other receivables | - | 1,733,363 | - |
| Financial liabilities at amortized cost: | | | |
| Trade and other payables | - | 1,894,778 | - |
| Long-term note payable | - | 386,159 | - |

## 11. Property and equipment:

(a) As at December 31, 2019 and 2018, there were no assets pledged as security.

(b) Reconciliation of property and equipment:

| | Furniture and Equipment | Computer equipment | ROU Asset | Construction in progress | Leasehold improvements | AUV Vehicle | Total |
|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | |
| **Balance at January 1, 2018** | **$ 118,771** | **$ 91,144** | **$ -** | | **$ 115,677** | **$ 1,489,175** | **$ 1,814,767** |
| Additions | 221,938 | 47,643 | - | | - | - | 269,581 |
| Kraken Power Acquisition (note 9) | 191,101 | 33,447 | | | | | 224,548 |
| Disposals | | (4,005) | | | | | (4,005) |
| **Balance at December 31, 2018** | **$ 531,810** | **$ 168,229** | **$ -** | | **$ 115,677** | **$ 1,489,175** | **$ 2,304,891** |
| IFRS 16 Adoption (note 3) | - | - | 1,518,040 | - | - | - | 1,518,040 |
| Balance at January 1, 2019 | 531,810 | 168,229 | 1,518,040 | - | 115,677 | 1,489,175 | 3,822,931 |
| Additions | 513,313 | 120,027 | 90,695 | 91,318 | 918,407 | - | 1,733,760 |
| Disposal and transfer to inventory | (631) | | | | | (1,489,175) | (1,489,806) |
| Foreign Exchange | (21,946) | (1,107) | | | | | (23,053) |
| **Balance at December 31, 2019** | **$ 1,022,546** | **$ 287,149** | **$1,608,735** | **$ 91,318** | **$ 1,034,084** | **$ -** | **$ 4,043,832** |
| **Accumulated depreciation** | | | | | | | |
| **Balance at January 1, 2018** | **$ 31,939** | **$ 44,272** | **$ -** | | **$ 55,782** | **$ 77,251** | **$ 209,244** |
| Depreciation (adjustments) | 47,865 | 26,351 | - | | 19,279 | 186,147 | 279,642 |
| Disposals | | (1,836) | | | | | (1,836) |
| **Balance at December 31, 2018** | **$ 79,804** | **$ 68,787** | **$ -** | | **$ 75,061** | **$ 263,398** | **$ 487,050** |
| Depreciation | 180,739 | 64,352 | 247,157 | | 166,351 | 108,586 | 767,185 |
| Disposal and transfer to inventory | (343) | | | | | (371,984) | (372,327) |
| **Balance at December 31, 2019** | **$ 260,200** | **$ 133,139** | **$ 247,157** | **$ -** | **$ 241,412** | **$ -** | **$ 881,908** |
| **Carrying amounts** | | | | | | | |
| **At December 31, 2018** | **$ 452,006** | **$ 99,442** | **$ -** | **$ -** | **$ 40,616** | **$ 1,225,777** | **$ 1,817,841** |
| **At December 31, 2019** | **$ 762,346** | **$ 154,010** | **$1,361,578** | **$ 91,318** | **$ 792,672** | **$ -** | **$ 3,161,924** |

## 11. Property and equipment (continued):

Kraken recognized a gain on the disposal of assets with a carrying value of $419,217 related to the sale of ThunderFish® Alpha AUV. Components of the ThunderFish® that were not sold, with a carrying value of $697,974, which can be used in the manufacture of other products, have been reclassified to inventory.

## 12. Goodwill and intangible assets:

Reconciliation of Intangibles:

| | December 31, 2018 | Amortization | Movement in exchange rates | Net carrying amount 2019 |
|---|---|---|---|---|
| Indefinite life intangible assets: | | | | |
| Trademarks and Trade names | $ 85,872 | $ - | $ (5,665) | $ 80,207 |
| Finite life intangible assets: | | | | |
| Technology and trade secrets | 832,411 | (191,440) | (51,697) | 589,274 |
| Customer contracts | 632,671 | (627,126) | (5,545) | - |
| Customer relationships | 548,821 | (94,641) | (40,716) | 413,464 |
| | $ 2,099,775 | (913,207) | (103,622) | 1,082,945 |
| Goodwill | 371,883 | | (24,533) | 347,350 |

| | Acquired during period | Amortization | Movement in exchange rates | Net Carrying amount 2018 |
|---|---|---|---|---|
| Indefinite life intangible assets: | | | | |
| Trademarks and Trade names | $ 82,610 | $ - | $ 3,262 | $ 85,872 |
| Finite life intangible assets: | | | | |
| Technology and trade secrets | 875,667 | (44,263) | 1,007 | 832,411 |
| Customer contracts | 845,327 | (213,721) | 765 | 632,671 |
| Customer relationships | 572,262 | (24,105) | 667 | 548,821 |
| | $ 2,376,166 | (282,089) | 5,698 | 2,099,775 |
| Goodwill | 357,759 | - | 14,124 | 371,883 |

For the purpose of impairment testing, goodwill is allocated to the Corporation’s cash-generating units which represent the lowest level within the Company at which the goodwill is monitored for internal management purposes, which is not higher than the Company’s operating segments.

**12. Goodwill and intangible assets (continued):**

*Power:*

As of December 31, 2019, the aggregate carrying amount of the Company's goodwill is $347,350 (2018 - $371,883).

Goodwill impairment testing requires a comparison of the carrying value of the asset to the higher of (i) value in use; and (ii) fair value less costs to sell. Value in use is defined as the present value of future cash flows expected to be derived from the asset in its current state. The principal factors used in the discounted cash flow analysis requiring significant estimation are the projected results of operations, the discount rate based on the weighted average cost of capital ("WACC"), and terminal value assumptions. The Company's value in use test was based on a WACC of 15% an average estimated compound annual growth rate of approximately 9% from 2020 to 2024; and a terminal year earnings before interest, taxes, depreciation and amortization ("EBITDA") multiplied by a terminal value multiplier of 4.4; and a WACC of 15% and a terminal year free cash growth rate of 2%.

As the recoverable amount of the Power segment was determined to be greater than its carrying amount, no impairment loss was recorded in 2019.

**13. Bank indebtedness:**

At December 31, 2019, the Company had a $1,000,000 line of credit for general operating purposes (the "operating line"). The operating line bears interest at the bank's prime rate plus 2.5%, payable monthly and is secured with a General Security Agreement. As at December 31, 2019, a total of $Nil (2018 - $Nil) was drawn against this facility.

**14. Long Term Note Payable:**

At December 31, 2018, the Company's subsidiary Kraken Power GmbH had a long-term liability consisting of a €400,000 loan with a German regional economic development organization due March 31, 2023. The loan has a profit participation feature whereby if Kraken Power is profitable, the lender will receive 1.5% of the profits up to an annual cap of €6,000. The loan currently bears interest at 8.5% and is unsecured. Completion of the Kraken Power transaction triggered a change of control payment to an arm's length third-party lender to Kraken Power in an amount equal to €120,000 payable in two tranches of €60,000 in 2020, which is included in trade and other payables.

**15. Share capital:**

Authorized: Unlimited number of common shares

See the consolidated statements of changes in shareholders' equity for a summary of changes in Share capital and Contributed surplus for the years ended December 31, 2019 and 2018.

(a) Private placements

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.

**15. Share capital (continued):**

On December 20, 2018 the Company closed a bought deal short form prospectus offering of common shares of the Company. A total of 15,000,000 common shares were sold at a price of $0.40 per common share for gross proceeds of $6,000,000. The Company paid the underwriters a cash commission equal to 6% of the gross proceeds and issued 550,000 broker warrants to the underwriters. Each warrant entitles the holder to purchase one common share at a price of $0.60 until December 20, 2020.

(b) Share purchase warrants

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.

In August 2018, 678,334 warrants were exercised early at a price of $0.30. In the same period 2,642,500 warrants were exercised at a price of $0.30 while 288,933 warrants expired unexercised.

In August 2018, 116,666 warrants were exercised at a price of $0.30 in connection with a debt settlement arrangement from August 2016.

In August 2018, 11,666 finder's warrants were exercised at a price of $0.18.

In September 2018, 650,000 warrants were exercised at a price of $0.30

In October 2018, 1,605,554 warrants were exercised at a price of $0.30.

In November 2018, 500,000 warrants were exercised at a price of $0.30.

In December 2018, the Company issued an additional 550,000 broker warrants in connection with the closing of a bought deal public offering of common shares.

In February 2019, 1,050,000 warrants were exercised at a price of $0.30.

In March 2019, 5,760,000 warrants held by Ocean Infinity were exercised at a price of $0.40 and 1,510,000 warrants were exercised at a price of $0.30. In April 2019, 557,776 warrants were exercised at a price of $0.30.

Share purchase warrant transactions are summarized for the years ending December 31, 2019 and 2018:

| | **Year ended December 31, 2019** | | | **Year ended December 31, 2018** | | |
|---|---|---|---|---|---|---|
| | Number of Warrants | Weighted Average Exercise Price | | Number of Warrants | Weighted Average Exercise Price | |
| Opening balance | 9,427,776 | $ | 0.38 | 22,996,423 | $ | 0.21 |
| Issued on private placement | - | | - | 5,760,000 | | 0.40 |
| Issued on bought deal | - | | - | 550,000 | | 0.60 |
| Warrants exercised | (8,877,776) | | 0.365 | (8,414,796) | | 0.26 |
| Warrants expired | - | | - | (11,463,851) | | 0.15 |
| Ending balance | 550,000 | $ | 0.60 | 9,427,776 | $ | 0.38 |
| Warrants exercisable | 550,000 | $ | 0.60 | 9,427,776 | $ | 0.38 |

**15. Share capital (continued):**

In addition to the warrants outlined above, in August 2018, 11,666 finder's warrants were exercised at a price of $0.18, and the remaining 168,001 finder's warrants expired during the period. In April 2019, 11,666 finder's warrants were exercised as a price of $0.18, there were no remaining finder's warrants to expire during the period.

At December 31, 2019 and December 31, 2018, the following share purchase warrants were outstanding:

| Expiry Date | Exercise Price | December 31, 2019 | December 31, 2018 | Weighted Average Remaining Contractual Life |
|---|---|---|---|---|
| April 11, 2019 | $0.30 | - | 3,117,776 | - years |
| December 20, 2020 | $0.60 | 550,000 | 550,000 | 1.00 years |
| June 20, 2021 | $0.40 | - | 5,760,000 | - years |
| | **$0.38** | **550,000** | **9,427,776** | **1.00 years** |

(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.

During 2018 the Company issued 450,000 options to an investor relations consultant, and 1,200,000 to employees. The options have a one to three-year term, with vesting in three equal instalments consisting of the date of grant and one and two-year anniversaries of the initial grant. The exercise price on the options range from $0.185 to $0.26.

At March 5, 2019 the Company issued 500,000 options to consultants. The options have a three-year term, with vesting in three equal instalments consisting of the date of grant and one and two-year anniversaries of the initial grant. The exercise price on the options was $0.70

At July 15, 2019 the Company's board of directors approved granting of 1,000,000 options to an officer. The options are exercisable at a price of $0.63 per share. The options expire on July 14, 2024, vesting over the next two years on the following schedule: 250,000 vesting immediately, 250,000 vesting twelve months following date of grant and 500,000 vesting 24 months following the date of grant.

At July 15, 2019 the Company issued 1,500,000 options to the Company's Board of Directors. The options have a three-year term, with vesting in three equal instalments consisting of the date of grant and one and two-year anniversaries of the initial grant. The exercise price on the options was $0.63.

At July 15, 2019 the Company issued 400,000 to an investor relations consultant exercisable at $0.63. The options have a three-year term and vest over a one -year period.

At September 9, 2019 the Company issued 2,755,000 stock options to employees. The options have a three-year term, with vesting in three equal instalments consisting of the date of grant and one and two-year anniversaries of the initial grant. The exercise price on the options was $0.53.

**15. Share capital (continued):**

The following options were outstanding as at December 31, 2019 and 2018:

| | December 31, 2019 | | December 31, 2018 | |
|---|---|---|---|---|
| | Number of Options | Weighted Average Exercise Price | Number of Options | Weighted Average Exercise Price |
| Opening balance | 6,940,834 | $ 0.197 | 7,130,000 | $ 0.18 |
| Granted | 6,155,000 | 0.59 | 1,650,000 | 0.18 |
| Exercised | (1,025,666) | 0.154 | (263,333) | 0.19 |
| Expired | (18,334) | 0.18 | (1,575,833) | 0.24 |
| Ending balance | 12,051,834 | $ 0.402 | 6,940,834 | $ 0.197 |
| Options exercisable | 7,234,334 | $ 0.376 | 5,090,834 | $ 0.196 |

| **Weighted Average Exercise Price** | **Expiry Date** | **Number Outstanding** | **Number Exercisable** | **Weighted Average Remaining Contractual Life** |
|---|---|---|---|---|
| 0.21 | June 1, 2020 | 2,000,000 | 2,000,000 | 0.42 years |
| 0.17 | September 8, 2020 | 350,000 | 350,000 | 0.69 years |
| 0.18 | October 4, 2020 | 300,000 | 200,000 | 0.76 years |
| 0.18 | December 15, 2020 | 1,596,834 | 1,499,334 | 0.96 years |
| 0.185 | February 20, 2021 | 450,000 | 450,000 | 1.14 years |
| 0.21 | June 21, 2021 | 200,000 | 133,333 | 1.47 years |
| 0.26 | July 18, 2021 | 1,000,000 | 666,667 | 1.55 years |
| 0.70 | March 5, 2022 | 500,000 | 166,667 | 2.18 years |
| 0.63 | July 14, 2022 | 1,500,000 | 500,000 | 2.54 years |
| 0.63 | July 14, 2022 | 400,000 | - | 2.54 years |
| 0.53 | September 8, 2022 | 2,755,000 | 918,333 | 2.69 years |
| 0.63 | July 14, 2024 | 1,000,000 | 250,000 | 2.69 years |
| **$ 0.376** | | **12,051,834** | **7,234,334** | **1.79 years** |

(d) Share-based compensation

During the year ended December 31, 2019, the Company recorded share-based compensation totaling $1,370,745 (2018 - $342,600), 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.

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

| | **Year ended December 31, 2019** | **Year ended December 31, 2018** |
|---|---|---|
| Risk-free interest rate | 1.56-1.74% | 1.90 to 2.24% |
| Expected life of options | 3 years | 3 years |
| Expected volatility | 104% to 107% | 114% to 119% |
| Weighted average fair value per option | $0.35 to $0.44 | $0.13 to $0.18 |
| Dividend yield | Nil | Nil |

## 16. 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 long-term note payable. The Company will make adjustment 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 debt or sell assets to reduce debt.

## 17: Revenue:

*Disaggregation of revenues*

The following table groups the Company's revenue based on the timing of revenue recognition for its products and services:

| | **December 31, 2019** | December 31, 2018 |
|---|---|---|
| Product sales – transferred at a point in time | **$ 14,394,964** | $ 6,471,784 |
| Service revenue - transferred over time | **751,012** | 236,172 |
| | **$ 15,145,976** | $ 6,707,956 |

Refer to note 23 for external revenue by geographic areas.

*Contract balances*

The timing of revenue recognition may differ from the timing of invoicing to customers. The Company recognizes unbilled revenue where professional services are performed or products are delivered prior to the Company's ability to invoice in accordance with the contract terms, or deferred revenue when revenue is recognized subsequent to invoicing.

The following table provides information about the Company's accounts receivable at December 31, 2019, which includes trade and unbilled revenue from contracts with customers.

| | **December 31, 2019** | December 31, 2018 |
|---|---|---|
| Trade receivables | **$ 3,236,207** | $ 987,415 |
| Unbilled revenue | **272,832** | 284,352 |
| Total receivables from contracts with customers | **3,509,039** | 1,271,767 |
| Government assistance receivable and other | **1,574,701** | 461,596 |
| Total accounts receivable | **$ 5,083,740** | $ 1,733,363 |

Refer to note 10 for further detail of accounts receivable breakdown

As at December 31, 2019, contract liabilities, which represents payments received from contracts with customers for which the criteria for revenue recognition has not yet been met, was $2,429,242 (2018 - $2,920,812).

**17: Revenue (continued):**

The following tables detail the changes in unbilled revenue and contract liabilities during the period.

| | | Unbilled revenue |
|---|---|---|
| Opening balance – January 1, 2019 | $ | 284,352 |
| Increase in unbilled from revenue recognized | | 483,706 |
| Decrease in unbilled from transfer to trade receivables and other adjustments | | (495,226) |
| **Ending Balance – December 31, 2019** | **$** | **272,832** |

| | | Deferred revenue |
|---|---|---|
| Opening balance – January 1, 2019 | $ | 2,920,812 |
| Increase in contract liabilities from payments received, excluding revenue | | 7,990,814 |
| Decreases in contract liabilities from revenue recognized that was included in the opening contract liabilities balance and other adjustments | | (8,466,403) |
| **Ending Balance – December 31, 2019** | **$** | **2,445,223** |

## 18. Government assistance:

During the year ended December 31, 2019, the Company received government assistance, excluding the OceanVision project, in the amount of $1,791,707 (2018 - $1,417,334). Government Assistance has been classified as a reduction to Cost of Sales $345,429 (2018 - $491,503), Research & Development expense $1,431,874 (2018 – $925,831), and Administrative expense $14,404 (2018 - $Nil). The financial statements reflect a cost reimbursement accrual made to recognize work under Kraken's OceanVision project, including $696,073 in reimbursements from the Ocean SuperCluster and $460,162 in reimbursements by funding partners. Assistance related to the OceanVision project has been classified as a reduction to Research & Development expense $751,779 (2018 – nil), Administrative expense $61,558 (2018 – nil) and Construction in progress of 342,898.

## 19. Related party transactions:

Compensation of key management personnel:

| | | 2019 | | 2018 |
|---|---|---|---|---|
| Share-based payments | **$** | **593,392** | $ | 95,500 |
| Short-term employee benefits | | **20,044** | | 13,129 |
| Salaries and wages | | **754,745** | | 533,500 |
| | **$** | **1,368,321** | $ | 642,129 |

## 20. Income taxes:

The Company's provision for income taxes differs from the amount computed by applying the combined Canadian federal and provincial income tax rates to income (loss) before income taxes as a result of the following:

| | For the year ended December 31, 2019 | 2018 |
|---|---|---|
| Net loss before taxes | **$ (3,047,653)** | $ (2,964,094) |
| Statutory tax rates | **27.0%** | 27.0% |
| Income taxes (recovery) computed at the statutory rates | **$ (822,866)** | $ (800,305) |
| Change in statutory rates and other | **(35,000)** | (98,000) |
| Permanent differences | **(493,000)** | (173,502) |
| Stock option expense | **370,000** | 92,502 |
| Bargain purchase gain | **-** | (291,000) |
| Change in unrecognized deductible temporary differences | **936,699** | 1,158,600 |
| Recorded income tax (recovery) | **$ (44,167)** | $ (111,705) |

The components of income tax expense (recovery) as recognized in the consolidated financial statements is as follows.

| | 2019 | 2018 |
|---|---|---|
| Current income tax expense (recovery) | **$ 17,218** | $ - |
| Deferred income tax expense (recovery) | **(61,385)** | (111,705) |
| | **$ (44,167)** | $ (111,705) |

The following deferred tax liabilities are recognized in the consolidated financial statements.

| | 2019 | 2018 |
|---|---|---|
| Deferred tax liabilities: | | |
| Property. Plant and equipment | **$ 31,000** | $ - |
| Intangibles | **378,000** | 529,281 |
| Other | **17,000** | - |
| | **$ 426,000** | $ 529,281 |

The net change in deferred tax liabilities for the year includes a reduction of $41,896 as a result of foreign exchange fluctuations.

The Company has the following deductible temporary differences, unused tax losses and unused tax credits for which no deferred tax asset is recognized in the consolidated financial statements:

| | 2019 | 2018 |
|---|---|---|
| Non-capital losses carried forward | **$ 3,056,000** | $ 2,276,000 |
| Capital losses carried forward | **-** | - |
| Property, plant and equipment | **186,000** | 144,000 |
| Investment tax credits | **240,000** | 46,000 |
| Deferred financing expenses | **174,000** | 144,000 |
| | **$ 3,656,000** | $ 2,610,000 |

## 20. Income taxes (continued):

The Company has non-capital losses which may be applied to reduce taxable income in future years, and which if not utilized, will expire through from 2028 through 2039. Deferred tax benefits which may arise as a result of deferred income tax assets have not been recognized in these consolidated financial statements as management believes that it is not probable that sufficient taxable income will be available to realize such assets.

Unrecognized deferred tax liabilities

Deferred tax is not recognized on the unremitted earnings of subsidiaries as the Company is in a position to control the reversal of the temporary difference and it is probable that such differences will not reverse in the foreseeable future. The unrecognized temporary difference at December 31, 2019 for the Company's subsidiaries was $5,345 (December 31, 2018 - $nil).

## 21. Change in non-cash working capital:

| | **2019** | **2018** |
|---|---|---|
| Increase in trade and other receivables | **$ (3,350,377)** | $ (821,100) |
| Decrease in investment tax credits receivable | - | 350,257 |
| Increase (decrease) in inventory | **(2,281,613)** | 851,182 |
| Increase (decrease) in prepayments | **(262,393)** | 52,995 |
| Increase (decrease) in trade and other payables | **1,562,587** | (4,280,016) |
| Increase (decrease) in contract liabilities | **(475,588)** | 541,000 |
| | **$ (4,807,385)** | $ (3,305,682) |

## 22. Commitments:

Kraken has established a long-term technical co-operation program with Fraunhofer for technologies that can be deployed in Kraken's ThunderFish® AUV program. While Kraken is contractually committed to grant research and development projects to Fraunhofer of €300,000 per year for a period of three more years (2019-2021), these projects will be awarded to Fraunhofer as various statement of works are agreed upon and purchase orders issued. The remaining commitment balance at December 31, 2019 is €736,700 and these projects will be expensed as incurred.

To fund the OceanVision project, Canada's Ocean Supercluster will provide an investment of $6.3 million, while the balance of the project will be provided by government agencies, industry partners (Petroleum Research Newfoundland and Labrador, Ocean Choice International and Nunavut Fisheries Association) and Kraken. Kraken's commitment to project is $7.4 million, of which $7.1 million remains outstanding at December 31, 2019. Kraken's commitment will be reduced as government and industry partners join the project in 2020.

With the adoption of IFRS 16 for Leases, the Company applies the short-term lease recognition exemption to its short-term leases (i.e., those leases that have a lease term of 12 months or less from the commencement date and do not contain a purchase option). It also applies the lease of low-value assets recognition exemption to leases of office equipment that are considered of low value (i.e., below $5,000). Lease payments on short-term leases and leases of low-value assets are recognized as expense on a straight-line basis over the lease term. The total value of these short-term lease commitments for 2019 is $109,737.

## 22. Commitments (continued):

Amount recognized in the statement of financial position and statements of comprehensive loss

Set out below are the carrying amounts of the Company's right-of-use assets and lease liabilities and the movements during the twelve-month period ended December 31, 2019.

| | **Right-of-use assets** (Leased Properties) | **Lease liabilities** |
|---|---|---|
| As at January 1, 2019 | 1,518,040 | 1,518,040 |
| Depreciation expense | (247,158) | - |
| Interest expense | - | 178,118 |
| Payments | - | (248,217) |
| Additions | 90,695 | 90,695 |
| **Subtotal** | **1,361,578** | **1,538,636** |
| **Less: current portion** | **-** | **(191,630)** |
| **As at December 31, 2019** | **1,361,578** | **1,347,006** |

Depreciation of right-of-use assets is included in depreciation and amortization expenses. Interest expense related to lease liabilities is included in financing costs.

The Company's minimum lease payments are as follows:

| | December 31, 2019 |
|---|---|
| Less than one year | 354,052 |
| One to three years | 814,139 |
| Three to five years | 171,183 |
| Thereafter | 476,883 |
| Minimum lease payments | 2,362,257 |
| Amounts representing finance charges | 823,621 |
| Net minimum lease payments | 1,538,636 |

The Company has short-term leases with lease terms of 12 months or less as well as low-value leases. As these costs are incurred, they are recognized as general and administrative expense. These costs were $109,737 in 2019 (2018 - $113,344).

## 23. Segmented information:

With the acquisition of Kraken Power in fiscal 2018, the Company now operates in two reportable operating segments, being: 1) " Sensors and Platforms" which is the design, manufacture and sale and provision of services for underwater sonar and laser scanner sensor equipment and underwater vehicle platforms; 2) "Power" which is the design, manufacture and sale of subsea power equipment such as drives, thrusters, and batteries.

The following tables present the operations of the Company's reportable segments as at and for the year ended December 31, 2019 and comparatives for December 31, 2018:

| December 31, 2019 | Sensors and Platforms | Power | Eliminations | Consolidated |
|---|---|---|---|---|
| **Revenue** | $ 15,405,058 | $ 9,305,922 | $ (9,565,004) | $ 15,145,976 |
| **Cost of Goods sold and operating expenses** | $ 20,206,523 | $ 6,458,672 | $ (8,515,733) | $ 18,149,462 |
| **Segment profit (loss)** | $ (4,801,465) | $ 2,847,250 | $ (1,049,271) | $ (3,003,486) |
| **Segment assets** | $ 14,977,678 | $ 6,285,352 | $ (3,172,154) | $ 18,090,876 |
| **Segment liabilities** | $ 8,210,984 | $ 2,415,137 | $ (2,198,563) | $ 8,427,558 |
| **Segment capital expenditures** | $ 1,347,080 | $ 386,680 | $ - | $ 1,733,760 |

| December 31, 2018 | Sensors and Platforms | Power | Eliminations | Consolidated |
|---|---|---|---|---|
| **Revenue** | $ 7,572,555 | $ 86,024 | $ (950,623) | $ 6,707,956 |
| **Cost of Goods sold and operating expenses** | $ 11,184,545 | $ 626,048 | $ (2,250,248) | $ 9,560,345 |
| **Segment profit (loss)** | $ (3,611,990) | $ (540,024) | $ 1,299,625 | $ (2,852,389) |
| **Segment assets** | $ 11,260,865 | $ 5,235,312 | $ (2,467,712) | $ 14,028,465 |
| **Segment liabilities** | $ 4,052,861 | $ 3,677,688 | $ (1,999,519) | $ 5,731,030 |
| **Segment capital expenditures** | $ 96,480 | $ 173,101 | $ - | $ 269,581 |

## 23. Segmented information (continued):

Revenues from external customers are attributed to geographic areas based on the location of the contracting customers. The following table sets forth external revenue by geographic areas:

| | 2019 | 2018 |
|---|---|---|
| Total revenues: | | |
| Canada | **$ 231,428** | $ 546,412 |
| United States | **3,118,345** | 664,900 |
| France | **-** | 535,382 |
| Italy | **145,504** | 76,746 |
| Israel | **64,754** | 1,513,026 |
| United Kingdom | **11,033,736** | 1,264,195 |
| Germany | **337,424** | 2,066,924 |
| Other | **214,785** | 40,372 |
| | **$ 15,145,976** | $ 6,707,956 |

For the year ended December 31, 2019, the Company had 2 customers that individually accounted for 72% and 14% of revenue and for the year ended December 31, 2018, the Company had 2 customers that individually accounted for 31%, 22% of revenue.

## 24. Subsequent events:

Subsequent to December 31, 2019, the Company:

(a) received $524,720 contract with Government of Canada for Kraken's SeaVision® 3D laser scanner. Kraken plans to conduct at-sea testing and evaluation of the SeaVision® system at a variety of archaeologically significant sites including the HMS Erebus and JHMS Terror at the National Historic Site of Canada, Nunavut.

(b) Signed an 8 year framework agreement with a leading international defense contractor. Kraken's Acoustic Signal Processing Group will provide development, maintenance, and training to the customer to enhance and modernize their sonar product.

(c) Received orders from four US companies and one Canadian company totaling $2.8 million for batteries and sonar sensors.

(d) During the month of January 2020, 191,667 options were exercised by employees for proceeds of $46,167. During the month of February 2020, 8,333 options were exercised by an employees for proceeds of $4,416.

(e) Subsequent to December 31, 2019 the COVID-19 outbreak was declared a pandemic by the World Health Organization. To date there has been no material impact on the Company's operations, however, the situation is dynamic and the ultimate duration and magnitude of the impact on the economy and the financial effect on our business is not known at this time. These impacts could include delays in obtaining new orders, delays with sea trials and ability to deliver products, an impact on our ability to obtain debt and equity financing, impairment of investments, impairments in the value of our long-lived assets, or potential future decreases in revenue or the profitability of our ongoing operations.