# Kraken Robotics Inc.

## Condensed Consolidated Interim Financial Statements

**For the three and six months ended June 30, 2019 and 2018**
**(Expressed in Canadian Dollars)**

**(Unaudited)**

## Q2 Fiscal 2019

**June 30, 2019**

**NOTICE TO READER**

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

The accompanying unaudited condensed consolidated interim financial statements of Kraken Robotics Inc. as at June 30, 2019 and for the six and three months ended June 30, 2019 and 2018, notes to unaudited condensed consolidated interim financial statements and related Management's Discussion and Analysis have been prepared by and are the responsibility of management.

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

KRAKEN

**June 30, 2019**

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

| | June 30, 2019 | December 31, 2018 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | **$ 5,398,244** | $ 4,929,865 |
| Trade and other receivables (note 5) | **2,263,025** | 1,733,363 |
| Investment tax credits recoverable (note 6) | **338,219** | - |
| Inventory (note 7) | **5,446,255** | 2,906,669 |
| Prepayments (note 8) | **446,645** | 169,069 |
| | **13,892,388** | 9,738,966 |
| Property and equipment (note 9) | **4,142,959** | 1,817,841 |
| Intangible assets | **1,697,030** | 2,099,775 |
| Goodwill | **357,758** | 371,883 |
| **TOTAL ASSETS** | **$ 20,090,135** | $ 14,028,465 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| Current Liabilities: | | |
| Trade and other payables | **2,138,867** | $ 1,894,778 |
| Deferred revenue | **6,497,469** | 2,920,812 |
| Current portion of lease liabilities (note 3) | **230,930** | - |
| | **8,867,266** | 4,815,590 |
| Long-term note payable | **368,203** | 386,159 |
| Lease liabilities (note 3) | **1,315,214** | - |
| Deferred Taxes | **613,344** | 529,281 |
| Shareholders' equity: | | |
| Share capital (note 12) | **22,193,154** | 18,166,572 |
| Contributed surplus | **1,045,890** | 1,774,264 |
| Non-controlling interests | **64,708** | 331,395 |
| Accumulated other comprehensive loss | **(149,393)** | (322,464) |
| Deficit | **(14,228,251)** | (11,652,332) |
| | **8,926,108** | 8,297,435 |
| **TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY** | **$ 20,090,135** | $ 14,028,465 |

Commitments (note 16) Subsequent events (note 17)

**On Behalf of the Board:**

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

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

| | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | **June 30, 2019** | **June 30, 2018** | **June 30, 2019** | **June 30, 2018** |
| Product Revenue | **$ 1,085,453** | $ 3,684,979 | **$ 2,197,521** | $ 3,684,979 |
| Service Revenue | **252,042** | 41,668 | **509,359** | 41,668 |
| | **1,337,495** | 3,726,647 | **2,706,880** | 3,726,647 |
| Cost of sales (note 7) | **708,837** | 1,416,742 | **1,489,465** | 1,650,889 |
| | **628,658** | 2,309,905 | **1,217,415** | 2,075,758 |
| Administrative expenses | **1,213,241** | 764,720 | **2,183,188** | 1,461,294 |
| Research and development costs | **789,198** | 683,986 | **999,421** | 1,345,443 |
| Depreciation and Amortization | **483,825** | 60,440 | **966,810** | 120,331 |
| Share-based compensation (note 12(d)) | **8,200** | 85,300 | **83,000** | 111,400 |
| Investment tax credits recoverable | **-** | - | **(338,219)** | (320,807) |
| | **2,494,464** | 1,594,446 | **3,894,200** | 2,717,661 |
| **(Loss) income from operating activities** | **(1,865,806)** | 715,459 | **(2,676,785)** | (641,903) |
| Foreign exchange loss | **77,639** | 62,390 | **81,767** | 141,233 |
| Financing costs | **45,469** | 14,628 | **92,812** | 35,350 |
| **Net (loss) income before taxes** | **$ (1,988,914)** | $ 638,441 | **$ (2,851,364)** | $ (818,486) |
| Deferred income tax recovery | **-** | **-** | - | **-** |
| **Net (loss) income** | **$ (1,988,914)** | $ 638,441 | **$ (2,851,364)** | $ (818,486) |
| **Net (loss) income attributed to:** | | | | |
| Shareholders of Kraken Robotics Inc. | **(1,751,755)** | $ 638,441 | **$ (2,526,987)** | $ (818,486) |
| Non-controlling interests | **(237,159)** | - | **(324,377)** | - |
| | **$ (1,988,914)** | $ 638,441 | **$(2,851,364)** | $ (818,486) |
| Basic and diluted (loss) income per share | **$(0.01)** | $ 0.01 | **$ (0.02)** | $ (0.01) |
| Basic and diluted weighted average number of shares outstanding | **145,921,411** | 105,303,701 | **146,002,595** | 100,761,196 |

The accompanying notes form part of the consolidated financial statements.

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

| | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | **June 30, 2019** | **June 30, 2018** | **June 30, 2019** | **June 30, 2018** |
| (Loss) income for the period | **$ (1,988,914)** | $ 638,441 | **$ (2,851,364)** | $ (818,486) |
| Other comprehensive (loss) income | | | | |
| *Items that may be reclassified to profit or loss* | | | | |
| Currency translation adjustment | **44,033** | 9,318 | **173,071** | (162,095) |
| **Other comprehensive (loss) income for the period** | **44,033** | 9,318 | **173,071** | (162,095) |
| **Comprehensive (loss) income for the period** | **$ (1,944,881)** | $ 647,759 | **$ (2,678,293)** | $ (980,581) |
| **Comprehensive (loss) income attributed to:** | | | | |
| Shareholders of Kraken Robotics Inc. | **$ (1,718,731)** | $ 647,759 | **$ (2,397,184)** | $ (980,581) |
| Non-controlling interests | **(226,150)** | - | **(281,109)** | - |
| **Comprehensive (loss) income for the period** | **$ (1,944,881)** | $ 647,759 | **$ (2,678,293)** | $ (980,581) |

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## Condensed Consolidated Interim Statements of Changes in Shareholders' Equity
## (Unaudited)
## (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 January 1, 2019 | **137,025,820** | **$ 18,166,572** | **$ 1,774,264** | **$ (322,464)** | **331,395 $** | **(11,652,332)** | **8,297,435** |
| IFRS 16 Adjustment (note 3) | | | | | | **(48,932)** | **(48,932)** |
| Net loss | - | - | - | - | **(324,377)** | **(2,526,987)** | **(2,851,364)** |
| Other comprehensive loss | | | | **173,071** | **57,690** | | **230,761** |
| Transactions with shareholders, recorded directly in equity: | | | | | | | |
| Issue of common shares on stock option exercises | **87,333** | **15,119** | | - | | - | **15,119** |
| Issue of common shares on warrant exercises | **8,889,442** | **4,052,807** | **(811,374)** | - | | - | **3,241,433** |
| Share issue costs (note 12(a)) | - | **(41,344)** | - | - | | - | **(41,344)** |
| Share-based compensation | - | - | **83,000** | - | | - | **83,000** |
| **Shareholders' equity as at June 30, 2019** | **146,002,595** | **$ 22,193,154** | **$ 1,045,890** | **$ (149,393)** | **$ 64,708 $** | **(14,228,251)** | **8,926,108** |

| 2018 | Number of Shares | Share capital (note 10) | 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)** | **$ - $** | **(7,359,237)** | **$ 535,412** |
| Adjustment to deficit – change in accounting policy | - | - | - | - | | **(1,576,594)** | **(1,576,594)** |
| Balance at January 1, 2018 | **90,992,740** | **$ 6,008,347** | **$ 2,157,803** | **$ (271,501)** | | **(8,935,831)** | **(1,041,182)** |
| Net loss | - | - | - | - | | **(818,486)** | **(818,486)** |
| Other comprehensive loss | | | | **(162,095)** | | | **(162,095)** |
| Transactions with shareholders, recorded directly in equity: | | | | | | | |
| Issue of common shares on private placement (note12(a)) | **22,234,285** | **3,142,900** | **661,100** | - | | - | **3,804,000** |
| Issue of common shares on stock option exercises | **100,000** | **14,700** | **(14,700)** | - | | - | - |
| Issue of common shares on warrant exercises | **2,221,742** | **540,533** | **(207,271)** | - | | - | **333,262** |
| Issue of common shares as Finder's Fee | **9,000** | **1,260** | - | - | | - | **1,260** |
| Expiry of Warrants | | **1,042,534** | **(1,042,534)** | - | | - | - |
| Share issue costs (note 12(a)) | - | **(51,096)** | - | - | | - | **(51,096)** |
| Share-based compensation | - | - | **111,400** | - | | - | **111,400** |
| **Shareholders' equity as at June 30, 2018** | **115,557,767** | **$10,699,177** | **$ 1,665,798** | **$ (433,596)** | **$ - $** | **(9,754,316)** | **$ 2,177,063** |

The accompanying notes form part of the consolidated financial statements.

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**Condensed Consolidated Interim Statements of Cash Flows**
**(Unaudited)**
**For the Six Months Ended June 30, 2019 and 2018**
**(Expressed in Canadian Dollars)**

| | | June 30, 2019 | June 30, 2018 |
|---|---|---|---|
| **Cash flows used in operating activities** | | | |
| Net loss | **$** | **(2,851,364)** | $ (818,486) |
| **Adjustments for items not involving cash:** | | | |
| Depreciation | | **383,265** | 120,230 |
| Depreciation of intangible assets | | **582,647** | - |
| Share-based payments | | **83,000** | 111,400 |
| Non-cash finance costs | | **-** | (2,037) |
| Investment Tax Credit | | **(338,219)** | (320,807) |
| IFRS 16 Lease Inducement Adjustment | | **48,932** | - |
| Interest on lease liability | | **88,956** | - |
| Changes in non-cash working capital | | **473,921** | (496,344) |
| **Net cash flows used in operating activities** | | **(1,528,862)** | (1,406,044) |
| **Cash flows from (used in) investing activities** | | | |
| Investment, note receivable and derivative asset | | **-** | 546 |
| Purchase of property, plant and equipment | | **(1,190,343)** | (15,113) |
| Decease in bank indebtedness | | **-** | (326,448) |
| | | **(1,190,343)** | (341,015) |
| **Cash flows from (used in) financing activities** | | | |
| Proceeds from equity offerings & option exercise | | **15,119** | 3,804,000 |
| Proceeds from exercise of warrants | | **3,241,433** | 333,262 |
| Share issue costs | | **(41,344)** | (49,836) |
| Payment of lease liability | | **(60,852)** | - |
| | | **3,154,356** | 4,087,426 |
| **Net increase in cash** | | **435,152** | 2,340,367 |
| **Effect of foreign exchange on cash** | | **33,227** | 488 |
| **Cash at beginning of period** | | **4,929,865** | - |
| **Cash at end of period** | **$** | **5,398,244** | $ 2,340,865 |

**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 its registered office is located at 100 King Street. West, #1600, Toronto, Ontario, M5X 1G5.

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

**2. Basis of presentation:**

(a) Statement of compliance:

These condensed consolidated interim financial statements, including comparatives, have been prepared in accordance with IAS 34, Interim Financial Reporting as issued by the International Accounting Standards Board ("IASB"). These financial statements were prepared using the same accounting policies and methods of computation and are subject to the same use of estimates and judgments, as the Company's consolidated financial statements for the year ended December 31, 2018, except as noted below in Note 3.

These condensed consolidated interim financial statements do not include all disclosures required by International Financial Reporting Standards ("IFRS") for annual consolidated financial statements and accordingly should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2018.

These consolidated financial statements were approved by the Board of Directors on August 28, 2019.

(b) Basis of measurement and reclassification of comparative figures

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

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

(c) 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 and the liabilities assumed 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.

(d) Accounting estimates and judgments:

The significant judgments made by Management in applying the Company's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the consolidated financial statements as at and for the year ended December 31, 2018.

i) 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

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

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.

**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 |

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

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.

**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 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 separately in the interim condensed consolidated statement of financial position.
- Lease liabilities of $1,518,040 were recognized and presented separately in the interim condensed 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.

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 six-month period ended June 30, 2019.

| | **Right-of-use assets** (Leased Properties) | **Lease liabilities** |
|---|---|---|
| As at January 1, 2019 | 1,518,040 | 1,518,040 |
| Depreciation expense | (120,220) | - |
| Interest expense | - | 88,956 |
| Payments | - | (60,852) |
| **As at June 30, 2019** | **1,397,820** | **1,546,144** |

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

Depreciation of right-of-use assets is included in general and administration expenses. Interest expense related to lease liabilities is included in other interest expense.

## 4. Significant accounting policies:

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

***IFRIC 23, Uncertainty over Income Tax Treatments:***

The Interpretation provides guidance on the accounting for current and deferred tax labilities and assets in circumstances in which there is uncertainty over income tax treatments. It requires an entity to contemplate whether uncertain tax treatments should be considered separately, or together as a group, based on which approach provides better predictions of the resolution. Probability will be determined whether the tax authorities will accept the uncertain tax treatment, and if it is not probable that the uncertain tax treatment will be accepted, they will measure the tax uncertainty based on the most likely amount or expected value, depending on whichever method better predicts the resolution of the uncertainty. There was no impact to the financial statements as a result of adopting this Interpretation effective January 1, 2019.

## 5. Trade and other receivables:

Trade and other receivables consist of the following:

| | June 30, 2019 | December 31, 2018 |
|---|---|---|
| Trade receivables | $ 905,073 | $ 987,415 |
| Unbilled accounts receivables | 745,020 | 284,352 |
| Government assistance receivable and other | 612,932 | 461,596 |
| | $ 2,263,025 | $ 1,733,363 |

## 6. Investment tax credit receivable

At June 30, 2019, the Company had filed its Scientific Research and Experimental Development (SR&ED) Expenditures Claim for the year ended December 31, 2018 and is entitled to a refundable Provincial Investment Tax Credit of approximately $338,219 (December 31, 2017 - $350,257) from the Canada Revenue Agency (CRA).

## 7. Inventory

As at June 30, 2019 the Company held $5,446,255 (December 31, 2018 - $2,906,669) in inventory**,** consisting of $1,989,513 (December 31, 2018 - $1,498,827) in raw materials and $3,456,741 (December 31, 2018 - $1,407,842) in work-in-progress. Included in cost of sales is inventory of $1,048,732 (December 31, 2018 - $1,274,744).

## 8. Prepayments

As at June 30, 2019, the Company had made prepayments of $130,415 (December 31, 2018 - $169,069) towards inventory to multiple vendors.

## 9. Property and equipment

| | Furniture and Equipment | Computer equipment | ROU Asset | 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 | 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** |
| Additions | 228,774 | 84,001 | | 877,568 | - | 1,190,343 |
| IFRS 16 Adoption | | | 1,518,040 | | | 1,518,040 |
| **Balance at June 30, 2019** | **$ 760,584** | **$ 252,230** | **$1,518,040** | **$ 993,245** | **$ 1,489,175** | **$ 5,013,274** |
| | | | | | | |
| **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 | 61,117 | 27,619 | 120,220 | 81,236 | 93,073 | 383,265 |
| **Balance at June 30, 2019** | **$ 140,921** | **$ 96,406** | **$ 120,220** | **$ 156,297** | **$ 356,471** | **$ 870,315** |
| | | | | | | |
| **Carrying amounts** | | | | | | |
| **At December 31, 2018** | **$ 452,006** | **$ 99,442** | **$ -** | **$ 40,616** | **$ 1,225,777** | **$ 1,817,841** |
| **At June 30, 2019** | **$ 619,663** | **$ 155,824** | **$ 1,397,820** | **$ 836,948** | **$ 1,132,704** | **$ 4,142,959** |

## 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:

| | June 30, 2019 | December 31, 2018 |
|---|---|---|
| Cash and cash equivalents | $ 5,398,244 | $ 4,929,865 |
| Trade and other receivables | 2,263,025 | 1,733,363 |
| Share subscription receivable | 76,833 | 76,833 |
| Prepayments | 446,645 | 169,069 |
| | $ 8,184,747 | $ 6,909,130 |

At June 30, 2019, 65% of the trade receivables balance was owing from 2 customers (December 31, 2018 – 58% of the trade receivables was owing from 2 customers).

### 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

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

and stressed conditions. As of June 30, 2019, the Company had a cash balance of $5,398,244 (December 31, 2018 - $4,929,865) to settle current liabilities of $8,867,266 (December 31, 2018 - $4,815,590), the majority of which is made up of deferred revenues of $6,497,469 (December 31, 2018– $2,920,812).

**Market Risk:**

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

(a) Interest rate risk

At June 30, 2019, the Company has cash balances of $5,398,224 and has drawn $Nil against its line of credit. The operating line bears interest at the bank's prime rate plus 2%, payable monthly.

The Company is exposed to interest rate risk on its line of credit balance.

(b) Foreign currency risk

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

**Market Risk**

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

| | June 30, 2019 | December 31, 2018 |
|---|---|---|
| Financial liabilities denominated in foreign currency: | | |
| Trade and other payables USD | $ 137,241 | $ 103,648 |
| Trade and other payables GBP | 67,480 | 16,000 |
| Trade and other payables EUR | 400,472 | 329,185 |
| Long-term debt EUR | 247,332 | 247,332 |
| Financial assets denominated in a foreign currency: | | |
| Trade and other receivables USD | 833,467 | 566,575 |
| Trade and other receivables GBP | - | - |
| Trade and other receivables EUR | 164,070 | 106,502 |

For the six months ended June 30, 2019 with other variables remaining constant, a 10% increase (decrease) in the exchange rate of the US dollar, British Pound and Euro to Canadian dollar exchange rate would have increased (decreased) the Company's net loss by approximately $471,430 respectively (2018 - $282,500).

**Fair Value:**

During the six months ended June 30, 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:

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

| **June 30, 2019** | **Level 1** | **Level 2** | **Level 3** |
|---|---|---|---|
| Financial assets classified as loans and receivables: | | | |
| Cash and cash equivalents | $ 5,398,244 | $ - | $ - |
| Trade and other receivables | - | 2,263,025 | - |
| Investment tax credits recoverable | - | 338,219 | - |
| Share subscription receivables | - | 76,833 | - |
| Financial liabilities at amortized cost: | | | |
| Trade and other payables | - | 2,138,867 | - |
| Long-term note payable | | 368,203 | - |

| **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 | - |
| Share subscription receivables | - | 76,833 | - |
| Financial liabilities at amortized cost: | | | |
| Trade and other payables | - | 1,894,778 | - |
| Long-term note payable | - | 386,159 | - |

**11. Bank indebtedness:**

At June 30, 2019, the Company had a $250,000 line of credit for general operating purposes (the “operating line”). The operating line bears interest at the bank’s prime rate plus 2%, payable monthly. As at June 30, 2019, a total of $Nil (December 31, 2018 - $Nil) was drawn against this facility

**12. Share capital:**

Authorized: Unlimited number of common shares

See the consolidated statements of changes in shareholders’ equity (deficiency) for a summary of changes in Share capital and Contributed surplus for the periods ended June 30, 2019 and 2018.

(a) Equity Financings

On April 11, 2017, the Company closed a non-brokered private placement offering comprised of 11,806,660 units at a purchase price of $0.18 per Unit for aggregate proceeds of $2,125,199. Each Unit consisted of one common share and on-half of one common share purchase warrant (each whole common share purchase warrant, a “Warrant”) with each Warrant exercisable to acquire one common share of Kraken at $0.30 for a period of 24 months from the date of issuance. The Company paid a cash finder’s fees of $12,600 and issued 191,333 finders warrants, and $73,282 legal and other costs, in connection with the offering. The gross proceeds of the financing are allocated between Share Capital and Contributed Surplus. The value of the warrants is determined using the Black Scholes pricing model and resulted in a $284,900 allocation to Contribution Surplus, with the remainder of $1,840,299 being allocated to Share Capital.

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

On February 25, 2018, the Company closed a non-brokered private place 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.

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

On February 18, 2015, as part of the reverse-takeover of Anergy Capital Inc. ("RTO"), the lenders of a $2,109,500 bridge loan to Kraken Robotic Systems Inc. converted the indebtedness into 14,063,326 common shares in the Company. On conversion of the bridge loan, the lenders also received share purchase warrants convertible into the same number of shares exercisable at a price of $0.15 per warrant for a period of thirty-six (36) months from the date of issuance.

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

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

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

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

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

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

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

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

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

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 periods ending June 30, 2019 and December 31, 2018:

| | **Six months ended June 30, 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 for private placement | - | - | 5,760,000 | 0.40 |
| Issued on bought deal | - | - | 550,000 | 0.60 |
| Warrants exercised | (8,877,776) | 0.36 | (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 |

At June 30, 2019 and December 31, 2018, the following share purchase warrants were outstanding:

| **Expiry Date** | **Exercise Price** | **June 30, 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 | 1.48 years |
| June 20, 2021 | $0.40 | - | 5,760,000 | - years |
| | **$0.60** | **550,000** | **9,427,776** | **1.48 years** |

## 12. Share capital (continued):

(c) Share options

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

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

The following options were outstanding as at June 30, 2019 and December 31, 2018:

| | June 30, 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 | 500,000 | 0.70 | 1,650,000 | 0.18 |
| Exercised | (87,332) | 0.18 | (263,333) | 0.19 |
| Expired | - | - | (1,575,833) | 0.24 |
| Ending balance | 7,353,502 | $ 0.23 | 6,940,834 | $ 0.197 |
| Options exercisable | 5,269,335 | $ 0.208 | 5,090,834 | $ 0.196 |

| **Weighted Average Exercise Price** | **Expiry Date** | **Number Outstanding** | **Number Exercisable** | **Weighted Average Remaining Contractual Life** |
|---|---|---|---|---|
| 0.15 | October 12, 2019 | 600,000 | 600,000 | .28 years |
| 0.15 | December 1, 2019 | 300,000 | 300,000 | .42 years |
| 0.21 | June 1, 2020 | 2,000,000 | 2,000,000 | .92 years |
| 0.17 | September 8, 2020 | 350,000 | 233,334 | 1.19 years |
| 0.18 | October 4, 2020 | 300,000 | 200,000 | 1.27 years |
| 0.18 | December 15, 2020 | 1,653,502 | 1,031,835 | 1.46 years |
| 0.185 | February 20, 2021 | 450,000 | 337,500 | 1.65 years |
| 0.21 | June 21, 2021 | 200,000 | 66,667 | 1.98 years |
| 0.26 | July 18, 2021 | 1,000,000 | 333,333 | 2.05 years |
| 0.70 | March 5, 2022 | 500,000 | 166,667 | 2.68 years |
| **$ 0.24** | | **7,353,502** | **5,269,336** | **1.39 years** |

(d) Share-based compensation

During the three-month and six-month period ended June 30, 2019, the Company recorded share-based compensation totaling $8,200 and $ 83,000 (2018 - $85,300 and $111,400), which was expensed in operations with a corresponding increase in contributed surplus.

## 12. Share capital (continued):

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:

| | Six Months ended June 30, 2019 | Six Months ended June 30, 2018 |
|---|---|---|
| Risk-free interest rate | 1.74% | 0.96 to 1.95% |
| Expected life of options | 3 years | 3 years |
| Expected volatility | 103.81% | 118% to 211% |
| Weighted average fair value per option | $ 0.44 | $0.11 to $0.13 |
| Dividend yield | Nil | Nil |

## 13. 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, capital leases, and long-term note payable. The Company makes adjustments to the capital structure depending on economic conditions, its financial position and performance. In order to maintain or adjust the capital structure, the Company may issue new shares, buyback shares or pay dividends, issue new debt or sell assets to reduce debt.

## 14. Government assistance:

During the three and six months ended June 30, 2019, the Company received government assistance in the amount of $237,295 and $1,106,250 (2018- $210,218 and $530,451). Government Assistance has been classified as a reduction to Cost of Sales, and Research & Development expense. The table below identifies the classification for the last 6 quarters.

| | Government Assistance ($) | Cost of Sales ($) | Research & Development Costs ($) |
|---|---|---|---|
| **Q2 2019** | 237,295 | (106,925) | (130,370) |
| **Q1 2019** | 868,955 | (86,375) | (782,580) |
| **Q4 2018** | 611,753 | (181,432) | (430,320) |
| **Q3 2018** | 275,130 | (106,568) | (168,562) |
| **Q2 2018** | 320,234 | (106,964) | (213,270) |
| **Q1 2018** | 210,217 | (96,539) | (113,678) |

## 15. 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 six months ending June 31, 2019.

| | Sensors and Platforms | Power | Eliminations | Consolidated |
|---|---|---|---|---|
| **Revenue** | $ 2,775,258 | $ 212,804 | (281,182) | $ 2,706,880 |
| **Expenses** | $ 4,681,270 | $ 1,198,143 | $ (321,168) | $ 5,558,245 |
| **Segment profit (loss)** | $ (1,906,012) | $ (985,339) | $ 39,986 | $ (2,851,365) |
| **Segment assets** | $ 21,200,073 | $ 6,307,953 | $ (7,417,891) | $ 20,090,135 |
| **Segment liabilities** | $ 12,548,775 | $ 8,086,715 | $ (9,471,463) | $ 11,164,027 |
| **Segment capital expenditures** | $ 1,014,191 | $ 176,152 | $ - | $ 1,190,343 |

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:

| | Three months ended June 30, 2019 | Six months ended June 30, 2019 | Three months ended June 30, 2018 | Six months ended June 30, 2018 |
|---|---|---|---|---|
| **Total revenues:** | | | | |
| Canada | **13,920** | **133,150** | **-** | **-** |
| United States | **505,462** | **505,462** | **471,247** | **471,247** |
| Europe | **816,767** | **1,996,811** | **3,255,400** | **3,255,400** |
| Other | **1,346** | **71,457** | **-** | **-** |
| | **$1,337,495** | **$2,706,880** | **$ 3,726,647** | **$ 3,726,647** |

## 16. 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 intends 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. These projects will be expensed as incurred. For 2019, we have issued a purchase order for a research project to Fraunhofer totaling Euro 163,300.

With the adoption of IFRS 16 for Leases, 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

**16. Commitments (continued):**

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 $Nil.

**17. Subsequent events:**

**Subsequent to June 30, 2019, the Company:** .

(a) Was awarded $1.8 million of project funding from Husky Energy and the Province of Newfoundland and Labrador for the development of a laser chain inspection sensor based on the Company's SeaVision® laser scanner.

(b) Was awarded a $0.5 million contract from Geomar for SeaVision 3D laser scanners®.

(c) Renewed our Royal Bank of Canada Credit Facilities increasing our revolving demand facility from $0.25 million to $1 million.