



Kraken Robotics Inc.

Condensed Consolidated Interim Financial Statements

**For the three and nine months ended September 30, 2021 and 2020
(Expressed in Canadian Dollars)**

(Unaudited)

Q3 Fiscal 2021



September 30, 2021

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

	September 30, 2021	December 31, 2020
ASSETS		adjusted (note 5)
Current assets:		
Cash and cash equivalents	\$ 1,725,896	\$ 12,924,509
Restricted cash (note 18(c))	2,294,518	-
Trade and other receivables (note 3)	4,531,290	3,119,920
Current tax receivable	242,107	82,069
Inventory (note 4)	17,249,752	8,129,302
Prepayments (note 5)	1,416,438	859,320
	27,460,001	25,115,120
Restricted cash (note 18(c))	1,056,065	1,057,982
Prepayments (note 5)	312,727	529,230
Property and equipment (note 7)	17,009,861	6,709,735
Intangible assets (note 8)	10,695,536	1,035,109
Goodwill (note 8)	5,263,154	372,898
TOTAL ASSETS	\$ 61,797,344	\$ 34,820,074
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Bank indebtedness (note 11)	1,806,094	709,098
Trade and other payable	9,706,255	4,698,963
Contract liability (note 9)	6,658,249	8,761,477
Current portion of long-term obligations (note 12)	21,090	22,368
Current portion of lease liabilities	971,535	504,277
	19,163,223	14,696,183
Long-term obligations (note 12)	5,158,188	646,492
Lease liabilities	3,861,682	3,133,276
Deferred taxes	33,776	332,700
Contingent consideration (note 6)	6,846,512	-
Shareholders' equity:		
Share capital (note 13)	46,636,553	33,939,262
Contributed surplus	4,728,421	2,516,143
Accumulated other comprehensive loss	(221,821)	(119,628)
Deficit	(24,409,190)	(20,324,354)
	26,733,963	16,011,423
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 61,797,344	\$ 34,820,074
Commitments (note 18)		Subsequent events (note 19)

On Behalf of the Board:

"Karl Kenny"

Director

"Shaun McEwan"

Director

The accompanying notes form part of the condensed consolidated financial statements.



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

	Three months ended		Nine months ended	
	September 30, 2021	September 30, 2020	September 30, 2021	September 30, 2020
Product Revenue (note 9)	\$ 4,604,070	\$1,501,400	\$ 9,469,347	\$ 8,673,428
Service Revenue (note 9)	456,447	44,063	1,142,108	1,544,639
	5,060,517	1,545,463	10,611,455	10,218,067
Cost of sales (note 4)	3,114,287	741,777	5,755,215	5,353,778
	1,946,230	803,686	4,856,240	4,864,289
Administrative expenses	2,629,916	2,006,167	5,348,381	4,824,911
Research and development costs	583,304	527,781	1,428,849	771,786
Depreciation and Amortization	997,943	262,202	1,799,755	771,249
Share-based compensation (note 13(d))	189,150	412,319	419,559	868,097
Investment tax credits recoverable	-	-	(593,564)	(650,138)
	4,400,313	3,208,469	8,402,980	6,585,905
Loss from operating activities	(2,454,083)	(2,404,783)	(3,546,740)	(1,721,616)
Foreign exchange (gain)loss	(203,522)	139,771	(201,608)	123,619
Financing costs (note 16)	457,037	106,187	1,013,001	206,293
Gain on sale of property, plant and equipment	(34)	19,360	(354)	19,360
	253,481	265,318	811,039	349,272
Net income (loss) before taxes	\$ (2,707,564)	\$ (2,670,101)	\$ (4,357,779)	\$ (2,070,888)
Income tax recovery	134,823	66,605	272,943	66,605
Net loss	\$ (2,572,741)	\$ (2,603,496)	\$ (4,084,836)	\$ (2,004,283)
Basic and diluted loss per share	\$(0.01)	\$(0.02)	\$(0.02)	\$(0.01)
Basic and diluted weighted average number of shares outstanding	191,539,138	149,690,139	176,146,015	148,355,045

The accompanying notes form part of the condensed consolidated financial statements.



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

	Three months ended		Nine months ended	
	September 30, 2021	September 30, 2020	September 30, 2021	September 30, 2020
(Loss) for the period	\$ (2,572,741)	\$ (2,603,496)	\$ (4,084,836)	\$ (2,004,283)
Other comprehensive income (loss)				
<i>Items that may be reclassified to profit or loss</i>				
Currency translation adjustment	9,340	10,269	(102,193)	250,985
Other comprehensive income (loss) for the period	9,340	10,269	(102,193)	250,985
Comprehensive (loss) for the period	\$ (2,563,401)	\$ (2,593,227)	\$ (4,187,029)	\$ (1,753,298)



**Condensed Consolidated Interim Statements of Changes in Shareholders' Equity
(Unaudited)
For the Nine Months Ended September 30, 2021 and 2020
(Expressed in Canadian Dollars)**

2021	Number of Shares	Share capital (note 13)	Contributed Surplus	Accumulated other comprehensive loss	Deficit	Total
Balance at January 1, 2021	167,813,430	\$ 33,939,262	\$ 2,516,143	\$ (119,628)	\$ (20,324,354)	16,011,423
Net loss	-	-	-	-	(4,084,836)	(4,084,836)
Other comprehensive income				(102,193)		(102,193)
Transactions with shareholders, recorded directly in equity:						
Issue of common shares on stock option exercises	1,310,590	500,133	(196,182)	-	-	303,951
Issue of common shares	20,000,000	10,000,000	-	-	-	10,000,000
Issue of common shares on acquisition	12,068,965	5,276,000	-	-	-	5,276,000
Share-based compensation	-	-	419,559	-	-	419,559
Share issue costs settled in warrants	-	(1,988,901)	1,988,901	-	-	-
Share issue costs settled in cash	-	(1,089,941)	-	-	-	(1,089,941)
Shareholders' equity as at September 30, 2021	201,192,985	\$ 46,636,553	\$ 4,728,421	\$ (221,821)	\$ (24,409,190)	26,733,963
2020	Number of Shares	Share capital (note 13)	Contributed Surplus	Accumulated other comprehensive loss	Deficit	Total
Balance at January 1, 2020	147,177,186	\$ 22,594,846	\$ 2,220,924	\$ (363,031)	\$ (14,789,421)	9,663,318
Net loss	-	-	-	-	(2,004,283)	(2,004,283)
Other comprehensive income				250,985		250,985
Transactions with shareholders, recorded directly in equity:						
Issue of common shares on stock option exercises	3,231,667	1,063,271	(392,789)	-	-	670,482
Share-based compensation	-	-	868,097	-	-	868,097
Shareholders' equity as at September 30, 2020	150,408,853	\$ 23,658,117	\$ 2,696,232	\$ (112,046)	\$ (16,793,704)	9,448,599

The accompanying notes form part of the condensed consolidated financial statements.



**Condensed Consolidated Interim Statements of Cash Flows
(Unaudited)
For the Nine Months Ended September 30, 2021 and 2020
(Expressed in Canadian Dollars)**

	September 30, 2021	September 30, 2020
Cash flows used in operating activities		
Net loss	\$ (4,084,836)	\$ (2,004,283)
Adjustments for items not involving cash:		
Depreciation	1,314,889	549,233
Amortization of intangible assets	484,866	222,016
Share-based payments	419,559	868,097
Accretion expense	186,062	58,082
Interest on lease liability	260,766	148,211
Interest on long-term obligations	39,597	-
Income tax recovery	(272,943)	(66,605)
Loss (gain) on sale of property and equipment	(354)	19,360
Changes in non-cash working capital	(7,968,371)	47,815
Net cash flows used in operating activities	(9,620,765)	(158,074)
Cash flows from (used in) investing activities		
Acquisition of 13 Robotics Ltda (net of cash acquired) (note 6)	(209,618)	-
Acquisition of PGH Capital Inc. (net of cash acquired) (note 6)	(4,024,005)	-
Increase in restricted cash	(2,292,601)	-
Purchase of property and equipment	(3,781,019)	(858,112)
Increase in intangibles	(34,817)	-
	(10,342,060)	(858,112)
Cash flows from (used in) financing activities		
Gross proceeds from common shares	10,000,000	-
Proceeds from option exercise	303,951	670,482
Share issue costs	(1,089,941)	-
Payment of principal on leases	(488,890)	(140,988)
Payment of interest on leases	(260,766)	(148,211)
Decrease in bank indebtedness	(368,004)	302,416
Payment of principal long-term obligations	(15,945)	-
Payment of interest on long-term obligations	(39,597)	(39,859)
Proceeds from long-term obligations	640,239	156,022
	8,681,047	799,862
Net decrease in cash	(11,281,778)	(216,324)
Effect of foreign exchange on cash	83,165	(27,320)
Cash at beginning of period	12,924,509	2,097,199
Cash at end of period	\$ 1,725,896	\$ 1,853,555

The accompanying notes form part of the condensed consolidated financial statements.



**Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)
For the Three and Nine Months Ended September 30, 2021 and 2020**

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. 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, 2020.

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, 2020.

These consolidated financial statements were approved by the Board of Directors on November 26, 2021.

(b) The outbreak of coronavirus, specifically identified as “COVID-19”, has resulted in governments worldwide enacting emergency measures to combat the spread of the virus. These measures, which include the implementation of travel bans, self-imposed quarantine periods and social distancing, have caused material disruption to businesses globally resulting in an economic slowdown. Global equity markets have experienced significant volatility and weakness. Governments and central banks have reacted with significant monetary and fiscal interventions designed to stabilize economic conditions. The duration and impact of the COVID-19 outbreak is unknown at this time, as is the efficacy of the government and central bank interventions. It is not possible to reliably estimate the length and severity of these developments and the impact on the financial results and condition of the Corporation and its operating subsidiaries in future periods. During the period the company experienced minor delays in procuring components and conducting sea trials. The company received government assistance under the CEWS (Canada Emergency Wage Subsidy) program as disclosed in Note 15.

(c) Basis of measurement

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.

(d) 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 Robotics US Inc., Kraken Robotik GmbH, Kraken Power GmbH, Kraken Robotics Denmark ApS, Kraken Robotics Brasil Ltda (as of April 16, 2021), PGH Capital Inc (as of July 30, 2021), PanGeo Subsea Inc. (as of July 30, 2021) and PanGeo Subsea Scotland Inc. (as of July 30, 2021). All intercompany balances and revenue and expense transactions have been eliminated on consolidation.



**Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)
For the Three and Nine Months Ended September 30, 2021 and 2020**

2. Basis of presentation (continued):

(e) Accounting estimates and judgments

The preparation of condensed 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 condensed 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) Revenue recognition

We have multi-year contracts with our customers, and we must make judgments about when we have satisfied our performance obligations to our customers, either over a period of time or at a point in time. Revenue from some contracts are recognized over time using the input cost method, measured by the percentage of costs incurred to date to the estimated total costs for each contract. Judgement is used in determining the estimates of costs to complete.

ii) 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.

iii) 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 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).

iv) 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.



**Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)
For the Three and Nine Months Ended September 30, 2021 and 2020**

2. Basis of presentation (continued):

v) 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.

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.

vi) 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 value in use is defined as the present value of future cash flows expected to be derived from the asset in its current state.

3. Trade and other receivables:

Trade and other receivables consist of the following:

	September 30, 2021	December 31, 2020
Trade receivables (net of expected credit loss \$187,389)	\$ 2,195,831	\$ 1,093,232
Unbilled accounts receivables	512,857	524,189
Government assistance receivable and other	1,822,602	1,502,499
	\$ 4,531,290	\$ 3,119,920

4. Inventory

As at September 30, 2021, the Company held \$17,249,752 (2020 - \$8,129,302) in inventory, consisting of \$8,450,606 (2020 - \$5,913,420) in raw materials and \$8,799,146 (2020 - \$2,215,882) in work-in-progress. Included in the cost of sales for the three months and nine months ended September 30, 2021 is inventory of \$1,887,054 (2020 - \$531,289) and \$3,332,386 (2020 - \$3,137,215) respectively.



**Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)
For the Three and Nine Months Ended September 30, 2021 and 2020**

5. Prepayments

As at September 30, 2021, the Company had made prepayments of \$1,729,165 (2020 - \$1,388,550). Included in prepayments are advance payment guarantee fees of \$765,881 (2020 – \$936,326) and prepayments towards inventory of \$544,868 (2020 - \$176,210).

The company has adjusted the 2020 comparative statements of financial position to correct a \$529,230 misclassification in prepayments in the year ended December 31, 2020 between current assets and non-current assets consistent with the presentation as at September 30, 2021. As a result, working capital changed from \$10,948,167 to \$10,418,937.

6. Business combinations

13 Robotics Ltda

On April 16, 2021, the Company acquired a 100% interest in 13 Robotics Ltda based in Brazil for US\$220,000 cash (C\$273,241). The Corporation has determined that this transaction is a business combination as the assets acquired and liabilities assumed constitute a business. The transaction was accounted for using the acquisition method of accounting whereby the assets acquired, and liabilities assumed were recorded at their estimated fair value at the acquisition date.

Fair value of cash, accounts receivable and trade and other payables were deemed to be approximate to their carrying amounts due to the short-term nature of these assets and liabilities. Fair value of fixed assets and right-of-use assets has been determined based on market comparison and replacement cost techniques. Replacement cost of these assets has been determined and depreciated replacement cost reflects fair value.

Fair value of assets acquired and liabilities assumed	Brazilian Real R\$		Canadian \$
Cash	R\$	285,562	\$ 63,623
Accounts Receivable		12,484	2,782
Fixed Assets		1,261,033	280,958
Right-of-use asset		144,609	32,219
Intangibles: Goodwill		154,941	34,521
Trade and other payables		(632,234)	(140,862)
Fair value of assets acquired and liabilities assumed	R\$	1,226,395	\$ 273,241

PGH Capital

On July 30, 2021, the Corporation, acquired a 100% interest in PGH Capital Inc. (PanGeo) which operates through its subsidiaries, PanGeo Subsea Inc. and PanGeo Subsea Scotland Limited (collectively with PGH Capital, “PanGeo”). The aggregate consideration paid by the Corporation to acquire PanGeo is comprised of the following: (i) \$3.0 million in cash at closing; (ii) 12,068,965 common shares valued at \$7.0 million; (iii) \$4.0 million non-transferable promissory notes and (iv) Contingent consideration of up to \$9.0 million.

Contingent consideration of up to \$9.0 million is to be paid pursuant to an earn-out on the following terms: (i) an amount equal to 300% of the amount by which certain qualifying revenues in the one-year period immediately following the closing date exceeds \$9.5 million, up to a maximum payment of \$4.5 million (the “First Earn-Out Amount”); and (ii) the amount equal to 300% of the amount by which certain qualifying revenues in the two-year period immediately from the closing date exceeds \$21.5 million, up to a maximum payment of \$4.5 million less any amount paid pursuant to the First Earn-Out Amount (the “Second Earn-out” and together with the First Earn-Out Amount, the “Earn-Out Amounts”. The Corporation has estimated the present value of the contingent consideration at the date of acquisition to be approximately \$6,730,000 discounted by a rate of 17.37%



**Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)
For the Three and Nine Months Ended September 30, 2021 and 2020**

6. Business combinations (continued)

The Earn-Out Amounts will be paid within thirty business days following the filing deadline date or the actual filing date on SEDAR, whichever is the earliest, of Kraken's quarterly financial statements for the quarter that includes first or second year anniversary of the Closing Date, as the case may be. At Kraken's option and, subject always to the approval of the TSX Venture Exchange at the time, payments required to be made in respect of the Earn-Out Amounts may be satisfied by way of a cash payment equal to 50% of the Earn-Out Amount and the issuance of Common Shares having an aggregate value equal to the remaining 50% of the Earn-Out Amount then due and payable.

The Corporation has determined that this transaction is a business combination as the assets acquired and liabilities assumed constitute a business. The transaction was accounted for using the acquisition method of accounting whereby the assets acquired, and liabilities assumed were recorded at their estimated fair value at the acquisition date. Fair value of cash, accounts receivable and trade and other payables were deemed to be approximate to their carrying amounts due to the short-term nature of these assets and liabilities. The fair values shown below for fixed assets are preliminary pending the finalization of the depreciated replacement cost of fixed assets. Intangibles (patents and trade secrets, customer relationships and non-compete agreements) and goodwill of PanGeo are preliminary, pending finalization of independent valuation report. If new information is obtained about facts and circumstances that existed at the date of acquisition, identifies adjustments to the below amounts, or any additional provisions that existed at the date of acquisition, then the accounting for the acquisition will be revised.

Fair value of assets acquired and liabilities assumed	Canadian \$
Cash	\$ 1,041,336
Accounts Receivable	1,318,815
Prepaid Expenses	231,487
Inventory	268,804
Fixed Assets	5,885,848
Right-of-use asset	1,053,829
Intangibles	10,122,000
Goodwill	4,877,051
Trade and other payables	(3,904,829)
Bank indebtedness	(1,450,000)
Fair value of assets acquired and liabilities assumed	\$ 19,444,341

Consideration	Canadian \$
Cash paid	\$ 3,000,000
Assumption of ACOA loan liability	600,341
Kraken Robotics common shares	5,276,000
Promissory notes	3,818,000
Contingent consideration	6,750,000
Total Consideration	\$ 19,444,341

Since the date of acquisition, PanGeo contributed revenue of \$249,034 and net loss of \$1,155,516 excluding the amortization of acquired intangible assets. The Corporation incurred \$568,026 in acquisition costs related to the acquisition, which has been expensed as administrative expenses in the condensed consolidated interim statements of net loss. The goodwill is not tax deductible and has been allocated to the sensors and platforms cash generating unit. The acquired intangible assets are being amortized over their estimated useful lives as follows:

- Patents and trade secrets – 5 years
- Customer Relationships - 6 years
- Non-compete Agreements – 2 years



**Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)
For the Three and Nine Months Ended September 30, 2021 and 2020**

7. Property and equipment

	Furniture and Equipment	Computer equipment	ROU Asset	Construction in progress	Leasehold improvements	Marine Equipment	Total
Cost							
Balance at January 1, 2020	\$ 1,022,546	\$ 287,149	\$1,608,735	\$ 91,318	\$ 1,034,084	\$ -	\$ 4,043,832
Additions	362,264	114,339	2,353,303	1,062,009	463,502		4,355,417
Disposals	(66,553)	(108,654)	-	-	(115,676)		(290,883)
Foreign exchange	31,946	2,443	-	-	-		34,389
Balance at December 31, 2020	\$ 1,350,203	\$ 295,277	\$3,962,038	\$ 1,153,327	\$ 1,381,910	\$ -	\$ 8,142,755
Additions	756,038	148,795	413,143	2,391,357	246,679	238,150	4,194,162
Purchase of Kraken Brasil Ltda.	9,681	4,916	22,565	300,953	-	-	338,115
Purchase of PGH Capital	88,861	914,440	1,353,746	-	135,076	4,776,246	7,268,369
Transfer				(1,049,433)		1,049,433	-
Disposals	(7,650)			(24,130)			(31,780)
Foreign Exchange	(28,903)	(6,187)	(117,545)		(2,683)	-	(155,318)
Balance at September 30, 2021	\$ 2,168,230	\$ 1,357,241	\$5,633,947	\$ 2,772,074	\$ 1,760,982	\$6,063,829	\$ 19,756,303
Accumulated depreciation							
Balance at January 1, 2020	\$ 260,200	\$ 133,139	\$ 247,157	\$ -	\$ 241,412		\$ 881,908
Depreciation	210,791	82,036	337,737		175,093		805,657
Disposals	(55,795)	(93,101)	-	-	(105,649)		(254,545)
Balance at December 31, 2020	\$ 415,196	\$ 122,074	\$ 584,894	\$ -	\$ 310,856	\$ -	\$ 1,433,020
Depreciation	234,373	129,609	550,006	-	191,837	208,884	1,314,709
Disposals	(1,287)	-	-	-	-	-	(1,287)
Balance at September 30, 2021	\$ 648,282	\$ 251,683	\$ 1,134,900	-	\$ 502,693	\$ 208,884	\$ 2,746,442
Carrying amounts							
At December 31, 2020	\$ 935,007	\$ 173,203	\$ 3,377,144	\$ 1,153,327	\$1,071,054	\$ -	\$ 6,709,735
At September 30, 2021	\$ 1,519,948	\$ 1,105,558	\$4,499,047	\$ 2,772,074	\$ 1,258,289	\$ 5,854,945	\$ 17,009,861



**Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)
For the Three and Nine Months Ended September 30, 2021 and 2020**

8. Goodwill and intangible assets:

Reconciliation of Intangibles:

	Trademarks and Trade names	Technology and trade secrets	Customer contracts	Customer relationships	Non-compete agreements	Goodwill	Total
Cost							
Balance at January 1, 2020	80,207	780,714	627,126	508,105	-	347,350	2,343,502
Additions	-	176,342	-	-	-	-	176,342
Movement in exchange rates	5,637	42,101	-	26,560	-	25,548	99,846
Balance at December 31, 2020	\$ 85,844	\$ 999,157	\$ 627,126	\$ 534,665	-	\$ 372,898	\$2,619,690
Additions (note 6)	1,787,500	3,163,317	-	4,997,000	209,000	4,911,572	15,068,389
Movement in exchange rates	(2,482)	(4,739)	-	(4,303)	-	(21,316)	(32,840)
Balance at September 30, 2021	\$ 1,870,862	\$ 4,157,735	\$ 627,126	\$ 5,527,362	209,000	\$ 5,263,154	\$17,655,239
Accumulated depreciation							
Balance at January 1, 2020	-	191,440	627,126	94,641	-	-	913,207
Depreciation	-	197,918	-	100,558	-	-	298,476
Balance at December 31, 2020	\$ -	\$ 389,358	\$ 627,126	\$ 195,199	\$ -	\$ -	\$ 1,211,683
Depreciation	-	257,241	-	210,208	17,417	-	484,866
Balance at September 30, 2021	\$ -	\$ 646,599	\$ 627,126	\$ 405,407	\$ 17,417	\$ -	\$1,696,549
Carrying amounts							
At December 31, 2020	\$ 85,844	\$ 609,799	\$ -	\$ 339,466	\$ -	\$ 372,898	\$1,408,007
At September 30, 2021	\$ 1,870,862	\$ 3,511,136	\$ -	\$ 5,121,955	\$ 191,583	\$5,263,154	\$15,958,690

9. Revenue

Disaggregation of revenues

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

	Three months ended September 30, 2021	Nine months ended September 30, 2021	Three months ended September 30, 2020	Nine months ended September 30, 2020
Product sales – transferred at a point in time	1,781,038	4,032,215	1,501,400	8,673,428
Product sales – transferred over time	2,823,032	5,437,132	-	-
Service revenue – transferred over time	456,447	1,142,108	44,063	1,544,639
	\$5,060,517	\$10,611,455	\$1,545,463	\$10,218,067



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9. Revenue (continued)

Refer to note 16 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 contract liabilities when revenue is recognized subsequent to invoicing.

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

Unbilled revenue	
Opening balance – January 1, 2021	\$ 524,189
Increase in unbilled from revenue recognized	836,474
Decrease in unbilled from transfer to trade receivables and other adjustments	(847,806)
Ending Balance – September 30, 2021	\$ 512,857
Contract Liabilities	
Opening balance – January 1, 2021	\$ 8,761,477
Increase in contract liabilities from payments received, excluding revenue recognized	3,713,009
Decreases in contract liabilities from revenue recognized	(5,816,237)
Ending Balance – September 30, 2021	\$ 6,658,249

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:

	September 30, 2021	December 31, 2020
Cash and cash equivalents and restricted cash	\$ 5,076,479	\$ 13,982,491
Trade and other receivables	4,531,290	3,119,920
	\$ 9,607,769	\$ 17,102,411

At September 30, 2021, 60% of the trade receivables balance was owing from 3 customers (2020 – 69% of the trade receivables was owing from 2 customers).

Credit risk is defined as our exposure to a financial loss if a debtor fails to meet its obligations in accordance with the terms and conditions of its arrangements with Kraken. We are exposed to credit risk on our accounts receivable and certain other assets through our normal commercial activities. We are also exposed to credit risk through our normal treasury activities on our cash and cash equivalents and restricted cash. Credit risks arising from our normal commercial activities are managed with regards to customer credit risk. Our customers are mainly established companies as well as government agencies, which facilitates risk assessment and monitoring. In addition, we typically receive substantial advance payments for contracts with customers. We do not hold any collateral as security. The credit risk on cash and cash equivalents and restricted cash is mitigated by the fact that the majority of the cash is held with high quality financial institutions in Canada, where management believes the risk of loss to be low.



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10. Financial instruments (continued):

Trade receivables include an expected credit loss. As of September 30, 2021, the amount is \$187,389 (2020 - \$167,405).

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 September 30, 2021, the Company had a cash balance of \$1,725,896 (December 31, 2020 - \$12,924,509), cash that will become unrestricted on December 31, 2021 of \$2,294,290 as well as accounts receivable of \$4,531,290 to settle current liabilities of \$19,163,223 (December 31, 2020 - \$14,696,183) of which contract liabilities make up \$6,658,249 (December 31, 2020 - \$8,761,477). Associated with two large contracts, the Company will receive progress payments of \$4,469,948 in 2021 and \$11,192,685 during 2022.

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 September 30, 2021, the Company held \$1,725,896 in cash and cash equivalents, \$3,350,583 in restricted cash, has drawn \$341,094 against its operating line of credit at Kraken Power and has drawn \$1,465,000 against its operating line of credit at PanGeo. The Kraken Power operating line of credit bears interest annually at 3.95%, payable monthly, which is a fixed interest rate and is not subject to interest rate risk and the PanGeo operating line of credit bears interest annually at the bank's prime plus 2.5%.

(b) Foreign currency risk

The Company's exposure to foreign currency risk is limited to sales, certain purchases, short term obligations and long term obligations in USD, EUR, GBP, DKK and BRL. 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:

	September 30, 2021	December 31, 2020
Financial liabilities denominated in foreign currency:		
Trade and other payables USD	1,640,616	427,353
Trade and other payables GBP	1,390,680	37,765
Trade and other payables EUR	1,391,176	847,397
Trade and other payables DKK	113,581	266,466
Trade and other payables BRL	486,465	-
Long-term debt EUR	876,382	423,945
Bank Indebtedness EUR	231,082	452,936
Financial assets denominated in a foreign currency:		
Trade and other receivables USD	1,041,498	613,188
Trade and other receivables GBP	644,271	-
Trade and other receivables EUR	226,936	108,471
Trade and other receivables DKK	8,436	2,577
Trade and other receivables BRL	22,519	-



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10. Financial instruments (continued):

Fair Value

The Company provides disclosure of the three-level hierarchy that reflects the significance of the inputs used in making the fair value measurement. The three levels of fair value hierarchy based on the reliability of inputs are as follows:

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

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, 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 Company does not record any asset or liability at fair value on an ongoing basis.

The carrying values of cash, restricted cash, accounts receivable, trade and other payables and bank indebtedness approximate their fair values due to their short term to maturity.

The fair values of the long-term obligations and contingent consideration are estimated using a discounted cash flow valuation technique. The fair value measurement for contingent consideration uses level 3 inputs based on estimates of future cash flows associated with the liabilities and discount rates that reflect market assessments of the performance risk which includes the credit risk of Company at September 30, 2021. The carrying value of the contingent consideration equals fair value as it is categorized as fair value through profit and loss. The fair value of the long-term debt is carried at amortized costs. For the fair value of contingent consideration, reasonably possible changes at September 30, 2021 to the risk-adjusted discount rate of 1%, holding other inputs constant. An increase (decrease) in discount rate would have increased (decreased) the Company's net loss by approximately \$98,438 and (\$100,865) respectively.

11. Bank indebtedness:

At September 30, 2021, the Company had available a \$1,500,000 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. As at September 30, 2021, a total of \$Nil (December 31, 2020 - \$Nil) was drawn against this facility. Security for operating line is a general security agreement. Kraken Power has a €500,000 line of credit for general operating purposes. The line bears interest of 3.95%, payable monthly. As at September 30, 2021 a total of €231,082 (\$341,094) (December 31, 2020 - €452,936 (\$709,098)) was drawn against this facility. The line of credit is guaranteed by a German regional economic development organization. Additionally, PanGeo had available a \$1,500,000 line of credit for general operating purposes. The operating line bears interest at the bank's prime rate plus 2.5%, payable monthly. As at September 30, 2021, a total of \$1,465,000 was drawn against this facility.



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12. Long-term obligations:

	September 30, 2021	December 31, 2020
Long-term note payable in the amount of €400,000 with a German regional economic development organization, due March 31, 2023, unsecured and bearing interest at 8.5% per annum.	\$ 477,841	\$ 463,741
Loan, secured by equipment, bearing interest at 1.4956%, in the amount of €89,019, repayable in equal installments of €1,306 over 72 months, and maturing on December 31, 2026.	114,715	139,365
Loan, secured by equipment and infrastructure, bearing interest at 1.23% currently in the amount of €486,948 with a maximum of €875,000 available, repayable in equal installments over 67 months beginning on September 30, 2021, maturing on March 31, 2027.	718,770	65,754
Promissory Note on acquisition of PanGeo, in the amount of \$4,000,000 bearing interest at 6% per annum, due July 30, 2023	3,867,952	-
	5,179,278	668,860
Less current portion of long-term obligations	(21,090)	(22,368)
	\$ 5,158,188	\$ 646,492

The following tables detail the changes in long-term obligations during the period:

Opening balance – January 1, 2021	\$ 668,860
Proceeds from long-term obligations	640,239
Payment of principle	(15,945)
Payment of interest	(39,597)
Acquisition of PGH Capital (note 6)	3,818,000
Accretion expense	89,550
Foreign Exchange	18,171
Ending Balance – September 30, 2021	\$ 5,179,278

13. 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 periods ended September 30, 2021 and 2020.



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13. Share capital (continued):

(a) Private placements

On October 26, 2020 the Company closed a bought deal short form prospectus offering of common shares. A total of 15,500,000 common shares were sold at a price of \$0.67 per common share for gross proceeds of \$10,385,000. Total share issued costs amounted to \$946,407 which included the underwriters a cash commission equal to 6% as well as legal and accounting fees.

On July 26, 2021 the Company closed a bought deal short form prospectus offering of common shares. A total of 20,000,000 common shares were sold at a price of \$0.50 per common share for gross proceeds of \$10,000,000. Total share issued costs amounted to \$1,089,941 which included the underwriters cash commission equal to 6% as well as legal and accounting fees. In addition, the underwriters received 10,000,000 share purchase warrants at a price of \$0.60 per common share.

(b) Share purchase warrants

In December 2020, 495,000 warrants were exercised at a price of \$0.60, and 55,000 warrants expired unexercised.

At September 30, 2021 and December 31, 2020, the following share purchase warrants were outstanding:

Expiry Date	Exercise Price	September 30, 2021	December 31, 2020	Weighted Average Remaining Contractual Life
July 26, 2023	\$0.60	10,000,000	-	1.82 years
	\$0.60	10,000,000	-	1.82 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.



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13. Share capital (continued):

The following options were outstanding as at September 30, 2021 and December 31, 2020:

	September 30, 2021		December 31, 2020	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Opening balance	9,238,333	\$ 0.535	12,051,834	\$ 0.376
Granted	1,000,000	0.500	1,875,000	0.54
Exercised	(1,306,667)	0.233	(4,650,167)	0.20
Expired	(23,333)	0.530	(38,334)	0.408
Ending balance	8,908,333	\$ 0.518	9,238,333	\$ 0.535
Options exercisable	7,533,333	\$ 0.566	5,911,716	\$ 0.51

Weighted Average Exercise Price	Expiry Date	Number Outstanding	Number Exercisable	Weighted Average Remaining Contractual Life
0.70	March 5, 2022	500,000	500,000	0.43 years
0.63	July 14, 2022	1,500,000	1,500,000	0.79 years
0.63	July 14, 2022	400,000	400,000	0.79 years
0.53	September 8, 2022	2,633,333	2,633,333	0.94 years
0.44	May 1, 2023	75,000	50,000	1.58 years
0.57	July 14, 2023	1,500,000	1,000,000	1.79 years
0.51	August 5, 2023	300,000	200,000	1.85 years
0.63	July 14, 2024	1,000,000	1,000,000	2.79 years
0.50	July 30, 2026	1,000,000	250,000	4.83 years
\$ 0.574		8,908,333	7,533,333	1.75 years

(d) Share-based compensation

During the three and nine month period ended September 30, 2021, the Company recorded share-based compensation totaling \$199,342 and \$419,559 respectively (2020 - \$220,420 and \$455,778 respectively), 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.

During the three-month period ended September 30, 2021, the Company granted 1,000,000 options to a directors of the Company. The fair values of the options granted were estimated using the Black-Scholes option pricing model with the following assumptions:

	Nine Months ended September 30, 2021	Nine Months ended September 30, 2020
Risk-free interest rate	0.38%	0.22% to 0.29%
Expected life of options	5 years	3 years
Expected volatility	117.88% to 137.21%	115.13% to 116.51%
Weighted average fair value per option	\$0.35 - \$0.44	\$0.19 - \$0.39
Dividend yield	Nil	Nil



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

15. Government assistance:

During the three months and nine months ended September 30, 2021, the Company received government assistance, excluding the OceanVision project, in the amount of \$1,219,575 and \$3,228,391 respectively (2020 - \$1,322,687 and \$3,035,389). Government Assistance for the three months and nine months ended September 30, 2021 has been classified as a reduction to Cost of Sales \$433,577 (2020 - \$99,325) and \$646,482 (2020 - \$174,703) respectively, Research & Development expense \$411,052 (2020 - \$923,134) and \$1,723,678 (2020 - \$2,377,878) respectively and Administrative expense \$374,946 (2020 - \$300,228) and \$858,231 (2020 - \$482,808) respectively.

The financial statements reflect a cost reimbursement under Kraken's OceanVision project during the three months and nine months ended September 30, 2021, including \$250,057 (2020 - \$738,880) and \$1,156,542 (2020 - \$2,189,651) respectively in reimbursements from the Ocean SuperCluster and \$243,768 (2020 - \$305,708) and \$694,199 (2020 - \$725,053) respectively in reimbursements by funding partners. Assistance related to the OceanVision project has been classified as a reduction to Research & Development expense \$352,670 (2020 - \$851,695) and \$1,195,241 (2020 - \$2,024,102) respectively, Administrative expense \$38,938 (2020 - \$45,341) and \$101,591 (2020 - \$58,233) respectively, Cost of sales \$nil (2020 - \$32,282) and \$nil (2020 - \$58,578) respectively and Construction in progress of \$102,217 (2020 - \$115,271) and \$553,909 (2020 - \$773,790) respectively.

16. Financing costs:

	Three months ended September 30, 2021	Nine months ended September 30, 2021	Three months ended September 30, 2020	Nine months ended September 30, 2020
Interest on lease liabilities	93,955	260,766	48,105	148,211
Letters of credit and other	201,833	566,173	-	-
Accretion of long-term obligations	64,737	89,550	58,082	58,082
Fair value adjustment of contingent consideration	96,512	96,512	-	-
	\$457,037	\$1,013,001	\$106,187	\$206,293



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17. Segmented information:

The Company 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 nine months ending September 30, 2021 and comparatives for September 30, 2020:

September 30, 2021	Sensors and Platforms	Power	Consolidated
Revenue	\$ 8,071,562	\$ 2,539,893	\$ 10,611,455
Expenses	\$ 11,939,273	\$ 3,029,961	\$ 14,969,234
Segment loss before tax	\$ (3,867,712)	\$ (490,068)	\$ (4,357,779)
Segment assets	\$ 54,259,027	\$ 7,538,317	\$ 61,797,344
Segment liabilities	\$ 30,039,587	\$ 5,023,794	\$ 35,063,381
Segment capital expenditures	\$ 20,409,230	\$ 803,714	\$ 21,212,944
September 30, 2020	Sensors and Platforms	Power	Consolidated
Revenue	\$ 6,379,075	\$ 3,838,992	\$ 10,218,067
Expenses	\$ 10,655,181	\$ 1,633,774	\$ 12,288,955
Segment profit (loss) before tax	\$ (4,276,106)	\$ 2,205,218	\$ (2,070,888)
Segment assets	\$ 12,107,771	\$ 4,414,698	\$ 16,522,469
Segment liabilities	\$ 5,071,522	\$ 2,002,348	\$ 7,073,870
Segment capital expenditures	\$ 1,120,860	\$ 242,344	\$ 1,363,204

The following table sets forth external revenue by geographic areas based on the location of the contracting customers:

	Three months ended September 30, 2021	Nine months ended September 30, 2021	Three months ended September 30, 2020	Nine months ended September 30, 2020
Total revenues:				
Canada	267,972	349,527	485,356	708,358
United States	1,236,755	3,127,292	988,212	7,578,854
Europe	3,107,744	6,686,017	-	1,846,436
Other	448,046	448,619	71,895	84,419
	\$5,060,517	\$10,611,455	\$1,545,463	\$10,218,067



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18. Commitments:

- (a) 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 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 September 30, 2021 is \$10,414 and these projects will be expensed as incurred.
- (b) To fund the OceanVision project, Canada's Ocean Supercluster will provide an investment of \$6.3 million, while the balance of the project of \$12.5 million will be provided by government agencies, industry partners (Petroleum Research Newfoundland and Labrador, Ocean Choice International, Nunavut Fisheries Association and NSP Maritime Link Incorporated) and Kraken. Kraken's commitment to the project is \$4.7 million, of which \$2.0 million remains outstanding at September 30, 2021. Kraken's commitment will be reduced if and when additional government and industry partners join the project in the future.
- (c) A commercial bank issued standby letters of credit on behalf of the Company to customers in the amount of US\$1,802,916 (C\$2,294,517), US\$6,214,595 (C\$7,909,129) on advance guarantees secured by Export Development Canada, US\$1,802,917 (C\$2,294,518) and US\$829,802 (C\$1,056,064) for performance guarantee secured by restricted cash. The letters of credit expire on December 31, 2021, October 30, 2023, December 31, 2021 and October 31, 2024, respectively.
- (d) 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 2021 is \$12,639.

19. Subsequent events:

Subsequent to September 30, 2021, the Company:

- (a) On November 22, 2021 Kraken announced that Kraken Robotic Systems Inc. and PanGeo have been awarded \$7.1 million for two contracts from the Newfoundland Offshore Oil and Gas Industry Recovery Assistance (OOGIRA) Fund. The projects valued will be executed from Q4 2021 through Q4 2022.