



KRAKEN ROBOTICS INC.
MANAGEMENT DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED December 31, 2022
(Expressed in thousands of Canadian dollars unless otherwise stated)

This Management Discussion and Analysis ("MD&A") of Kraken Robotics Inc. (the "Company" or "Kraken") provides analysis of the Company's financial results for the year ended December 31, 2022 and should be read in conjunction with the Company's audited financial statements and the notes thereto for the year ended December 31, 2022, which are available under the Company's profile on SEDAR at www.sedar.com. This MD&A is current as at April 28, 2023, the date of preparation.

The December 31, 2022 financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). All amounts are expressed in thousands of Canadian dollars, unless otherwise stated.

Non-IFRS Measures

This MD&A also includes certain figures that are not performance measures consistent with the International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board. These measures are defined at the end of this MD&A under the heading "Non-IFRS Measures".

Notice Regarding Forward-Looking Statements

*This MD&A, and, in particular, the sections below entitled "Summary of Key 2022 Developments", "Use of Estimates and Judgments", "Capital Management", "Financial Instruments and Risk Management" and "Risks and Uncertainties" contain "forward-looking statements" and "forward-looking information" (collectively, "**forward-looking statements**") within the meaning of applicable Canadian securities legislation.*

In some cases, forward-looking statements can be identified by the use of forward-looking terminology such as "may", "will", "expect", "intend", "seek", "potential", "estimate", "anticipate", "believe", "could", "would", "should", "continue", "plans", "target", "is/are likely to", or the negative of these terms, or similar expressions intended to identify forward-looking statements. Within this MD&A, forward-looking statements may include, without limitation, statements with respect to Kraken's future plans, strategies and objectives, including:

- *expectations regarding revenue, expenses and operations;*
- *the ability to profitably execute on its contracts announced for products including: AquaPix® MINSAS, KATFISH™, ALARS, and SeaPower™ batteries; and services using the Sub Bottom Imager (SBI), Acoustic Corer (AC), KATFISH™ and SeaVision® 3D laser system.*
- *anticipated cash needs and the Company's needs for, and the Company's ability to secure, additional financing and/or government funding for working capital needs, debt repayment obligations and other contractual obligations of the Company;*
- *the Company's ability to maintain current and projected revenue if it fails to effectively compete for additional contracts;*
- *our ability and intention to expand Robotics as a Service and data analytics revenue;*
- *the Company's ability to protect, maintain and enforce its intellectual property rights;*
- *the Company's ability to defend itself against third-party claims of infringement or violation of, or other conflicts with, intellectual property rights by the Company;*
- *natural disasters, terrorist acts, civil unrest, pandemics and other disruptions and dislocations, such as COVID-19, may adversely affect the Company;*
- *the Company's ability to attract new customers;*
- *the Company's reliance on information technology systems or a material disruption in the Company's computer systems;*
- *the Company's ability to attract and retain personnel; and*
- *the Company's competitive position and its expectations regarding competition and its future success in competitive bidding processes.*

Forward-looking statements reflect the Company's current views with respect to future events and are subject to various known and unknown risks and uncertainties, which are necessarily based upon a number of estimates and assumptions that, while considered reasonable by Kraken, are inherently beyond the ability of the Company to control or predict, that may cause the Company's actual results, performance or achievements to be materially different from those expressed or implied thereby, and are developed based on assumptions about such risks, uncertainties and other factors set out herein, including but not limited to the factors referred to below under "Risks and Uncertainties". For additional information with respect to certain of these risks or uncertainties, reference should be made to the section entitled "Risks and Uncertainties" in this MD&A and to Kraken's continuous disclosure materials filed from time to time with the Canadian Securities Regulatory Authorities, including the Company's Annual Information Form for the financial year ended December 31, 2022 under the section entitled "Risk Factors", quarterly and annual reports, and supplementary information, which are available under the Company's profile on SEDAR at www.sedar.com. Additional risks and uncertainties not presently known to the Company or that Kraken believes to be less significant may also adversely affect the Company.

The Company undertakes no obligation to update forward-looking statements except as required by applicable law. Such forward-looking statements represent management's best judgment based on information currently available. No forward-looking statement can be guaranteed, and actual future results may vary materially. Accordingly, readers are cautioned not to place undue reliance on forward-looking statements.

OVERVIEW

Kraken Robotics Inc. was incorporated on May 14, 2008 under the Business Corporations Act, British Columbia and its registered office is at 100 King Street West, #1600, Toronto, Ontario, M5X 1G5.

Kraken Robotics Inc. is a marine technology company supplying advanced sonar and optical sensors, batteries, and underwater robotics equipment and services for military and commercial applications. The Company is recognized as world leading innovators of Synthetic Aperture Sonar (SAS) - a revolutionary underwater imaging technology that dramatically improves seabed surveys by providing ultra-high resolution imagery at superior coverage rates. Both military and commercial markets are showing significant growth and are now incorporating unmanned vehicles and intelligent sensors in their procurement plans and budgets. In July 2021, Kraken acquired, PanGeo Subsea Inc., which has been renamed Kraken Robotics Services Ltd on January 1, 2023. Kraken Robotics Services specializes in high-resolution 3D acoustic imaging solutions for the sub-seabed with offices in Canada, the United States and the United Kingdom.

Kraken's common shares are publicly traded on the TSX Venture Exchange under the symbol PNG and on the OTCQB under the symbol KRKNF.

VISION, MISSION AND VALUES

The Company's mission is driven by innovation. We develop unique subsea intelligence solutions for clients to overcome the challenges in our oceans – safely, efficiently, and sustainably. Our vision is to transform the future of subsea intelligence and enable our clients to explore, power, and protect the planet. Our core values involve safety and quality first, by being agile and accountable, while delivering value to our clients and stakeholders, and continuously driving innovation, thinking globally and acting locally.

SUMMARY OF KEY 2022 DEVELOPMENTS

- In 2022 Kraken continued to deliver on its contract to the Danish Ministry of Defence, Acquisition and Logistics Organization (DALO) to supply mine-hunting sonar equipment to the Royal Danish Navy. Under this contract awarded in September 2020, Kraken has been providing its mine-hunting KATFISH™ towed SAS system, the Tentacle® Winch system, and Autonomous Launch and Recovery System (ALARS) to be integrated onboard the Royal Danish Navy's optionally unmanned surface vessels. The aggregate value of the contract is \$36 million, deliverable over a 5-to-10-year period, with the majority of funds (approximately \$22 million) to be received over the two-to-three-year product acquisition phase, with the remaining funds (approximately \$14 million) being allocated to post sales service arrangements which will continue for the duration of the remaining term. At the end of 2022, the acquisition phase

of this project was largely delivered with integration and sea acceptance testing to be completed on various components in 2023. The sustainment portion of the contract begins during 2023.

- In March 2022, Kraken announced it had been awarded a \$5 million Acoustic Corer™ contract in the US Gulf of Mexico. This 90-day campaign was the largest Acoustic Corer™ project undertaken by the Company to date.
- In September 2022, Kraken announced that it had signed a \$9 million follow on contract to supply mine-hunting systems to a leading NATO Navy, which includes its KATFISH™ towed SAS system, Tentacle® Winch system, ALARS and topsides. Deliveries will occur in both 2023 and 2024.
- In September 2022, Kraken announced that it had received approval to sell its products and services to the Government of Canada under its Pathway to Commercialization initiative. Under this approval, direct purchases can be made up to \$8 million per contract and are available to all government departments.
- In November 2022, Kraken signed a research & development (“R&D”) contract with a global energy company which will provide \$8 million of cash funding to Kraken’s Brazilian subsidiary over a 3-year period. Under this project, Kraken will continue development of artificial intelligence and machine learning software, and subsea autonomy solutions to intelligently analyze sensor data and learn how to respond to highly dynamic environments in the offshore oil and gas, wind, hydrographic, science, and defense industries.
- In November 2022, Kraken received an initial order for subsea batteries valued at \$14 million with deliveries to occur in 2023. Since acquiring this business in 2018, Kraken has received orders of over \$38 million for its subsea batteries.
- Throughout 2022, Kraken received approximately \$7.0 million in orders for its SAS product compared to approximately \$3.0 million in the prior year. Demand for our SAS continues to increase over traditional side scan sonar driven by customer desire for strong intelligence about the subsea infrastructure in both shallow and deep-water installations and the modularity and versatility of our SAS having a track record of successful integration on over 20 different underwater platforms.
- In December 2022, Kraken was awarded a prime contract with the Government of Canada to provide Remote Mine-hunting and Disposal Systems for the Department of National Defense. The contract consists of an estimated 24-month acquisition program followed by an initial five-year Integrated Logistics Support (ILS) program, which includes options for additional equipment, spare parts, training, and technical support. If all options in the acquisition and ILS programs are selected, the total value will exceed \$50 million, consisting of approximately \$40 million for acquisition and \$10 million for ILS.

FINANCIAL HIGHLIGHTS

Consolidated revenue in Q4 2022 was \$8,813 compared to \$15,018 in Q4 2021, and \$40,908 for 2022, compared to \$25,629 in 2021. Both periods were supported by our deliveries to DALO under our acquisition contract, full year of revenue from our acquisition of Kraken Robotics Services (formerly PanGeo SubSea Inc.) and the continued growth in both our sensor and batteries businesses. Adjusted EBITDA⁽¹⁾ in Q4 2022 was \$931 compared to \$3,476 for the same period in the prior year with the decline associated with the timing of a large project delivery in Q4 2021. Adjusted EBITDA⁽¹⁾ for 2022 was \$5,292, compared to \$2,149 in 2021, and was positively impacted by continued work pursuant to the DALO acquisition contract, the full year impact of the PanGeo acquisition and the sale of sensors and batteries to both the commercial and defence markets.

SUMMARY OF RESULTS

Revenue

The Company’s product and service revenue can fluctuate significantly on a quarterly basis due to the timing of orders, lead times on part purchases and seasonality.

Kraken’s product business consists primarily of our AquaPix® MINSAS sensors, KATFISH™ systems, and SeaPower™ subsea battery systems. Product revenue in Q4 2022 was \$5,080 (2021 - \$12,682) and declined over the prior year due to a KATFISH™ system being delivered in Q4 of the prior year. Revenue in Q4 2022 was generated from the sale of subsea batteries, SAS sensors and continued work with the Royal Danish Navy. During 2022, the products business generated revenue of \$24.9 million compared to \$22.2 million in the prior year, an increase of 12% due to the sale of subsea batteries, SAS sensors and continued work with the Royal Danish Navy.

Kraken's services business consists of services provided by robotics as a service (RaaS) portfolio of equipment including our Sub-Bottom Imager™, Acoustic Corer™, KATFISH™, and SeaVision. Services revenue in Q4 2022 was \$3,733 (2021- \$2,336) an increase of 60% over the prior year due to increased activity in the industry. Services in 2022 increased to \$16,008 from \$3,478 in the prior year due to the full year impact from the acquisition as well as increased demand from customers in decommissioning work, depth of burial campaigns, geohazards, unexploded ordinances identification and infrastructure inspection.

	Three months ended		Twelve months ended	
	December 31, 2022	December 31, 2021	December 31, 2022	December 31, 2021
Product Revenue	\$ 5,080	\$ 12,682	\$ 24,900	\$ 22,151
Service Revenue	3,733	2,336	16,008	3,478
Total revenue	8,813	15,018	40,908	25,629
Cost of sales	4,420	8,555	23,871	14,310
Gross margin	4,393	6,463	17,037	11,319
Gross margin percentage	50%	42%	42%	44%
Administrative expenses	3,887	2,923	12,364	8,271
Research and development costs	176	881	1,262	2,310
Depreciation and Amortization	1,348	1,114	4,781	2,914
Share-based compensation	178	13	797	433
Investment tax credits recoverable	-	-	(634)	(594)
Income (loss) from operating activities	(1,196)	1,532	(1,533)	(2,015)
Foreign exchange loss (gain)	411	173	301	(29)
Financing costs	816	644	3,261	1,657
Loss on disposal of assets	-	-	207	-
Net loss before taxes	(2,423)	\$ 716	(5,302)	\$ (3,643)
Income tax recovery (expense)	1,153	167	1,059	106
Net loss	\$ (1,270)	\$ 548	\$ (4,243)	\$ (3,537)
Basic and diluted loss per share	\$ (0.01)	\$0.00	\$ (0.02)	\$ (0.02)
Basic and diluted weighted average number of shares outstanding	201,524,235	201,192,985	201,214,585	182,459,224
Adjusted EBITDA ⁽¹⁾	931	3,476	5,292	2,149
Adjusted EBITDA margin ⁽¹⁾	11%	23%	13%	8%

- Adjusted EBITDA is a non-IFRS financial measure and Adjusted EBITDA Margin is a non-IFRS ratio, in each case with no standard meaning under IFRS, and may not be comparable to similar financial measures disclosed by other issuers. Refer to the "Non-IFRS Measures" section of this MD&A.

Cost of Sales and Gross Margin

Cost of sales reflects the recognition of products based on shipments and the cost of delivery of services revenue as well as the allocation of wages of employees primarily engaged in product and services activities. Cost of sales in the quarter were \$4,420 (Q4 2021 - \$8,555) and were lower due to timing of shipment of a KATFISH™ system in Q4 2021. During Q4 2022, the Company realized gross margin of \$4,393 (Q4 2021 – \$6,463) resulting in a gross margin of 50% compared to 43% in Q4 2021. The increase in gross margin percentage reflects a change in product and service revenue mix in the current quarter to higher margin business compared to the prior year.

Cost of sales for 2022 were \$23,871 (2021 - \$14,310) an increase due to the growth in both the products and services business but also the full year impact of our acquisition of Kraken Robotics Services. As a result, gross margin in 2022 increased to \$17,037(2021 - \$11,319). Gross margin percentage for the year was 42% compared to 44% in the prior year due to change of revenue mix in 2022 compared to 2021 as well as the full year impact of the acquisition of Kraken Robotics Services. During the quarter, the Company recorded an impairment loss on inventory of \$397 (Q4 2021-nil) related to its thruster and control systems portfolio which is included in cost of sales.

Administration Expenses

Administration expenses in Q4 2022 increased 33% to \$3,887 (Q4 2021 - \$2,923) due to costs associated with growing our business. Notable items in the administration expense category include: salaries and benefits expenses increased 37% to \$1,678 (Q4 2021 - \$1,228), travel related costs increased \$438 (Q4 2021 - \$136) due to the easing of COVID related restrictions on travel, software subscriptions increased to \$311 (Q4 2021 - \$234), accounting and legal decreased to \$289 (Q4 2021 - \$423), office and shop supplies \$269 (Q4 2021 - \$182) and expected credit loss increased to \$172 (Q4 2021 - \$78).

Transaction and restructuring costs for Q4 2022 were \$204 (Q4 2021 -\$817) due to the acquisition of Kraken Robotics Services as well as increasing efficiency in operations.

Administration expenses for the twelve months increased by \$4,093 to \$12,364 (2021 - \$8,271) due to the acquisition of Kraken Robotics Services and increased activity across the Company. At the end of 2022, Kraken employed 211 employees compared to 225 in the prior year. Notable items in the administration expense category include: salaries and benefits increased to \$6,111 (2021 - \$3,726) due to decreased government assistance including the Canadian Emergency Wage Subsidy which was not present in 2022 and the full year inclusion of Kraken Robotics Services, travel related costs of \$1,066 (2021-\$232) which increased due to the easing of COVID related restrictions and the return of business meetings, trade shows and conferences, software subscriptions of \$994 (2021 - \$809). Accounting and legal costs declined slightly to \$810 (2021- \$964) as well as transfer agency services/public company fees declined to \$183 (2021 - \$361).

Transaction and restructuring costs for 2022 were \$850 (2021 -\$817) for the year primarily related to the acquisition of Kraken Robotics Services as well as increasing efficiency in operations.

Research and Development costs

R&D costs in the quarter decreased to \$176 (Q4 2021 - \$881), due to the timing of expenditures on various R&D programs as well as the timing of government assistance which are netted against R&D. For 2022, R&D costs decreased to \$1,262 (2021 - \$2,310) resulting from the timing of expenditures on various R&D programs and government assistance. Investment tax credits recoverable increased to \$634 (2021 - \$594) related to increased scientific research and experimental development activities.

Depreciation and Amortization

Depreciation and amortization increased in the quarter and for the year due to the increased asset base and intangibles associated with the acquisition of Kraken Robotics Services. Depreciation in the quarter totalled \$964 (Q4 2021 - \$795), while amortization of intangible assets increased to \$384 (Q4 2021 - \$319). For 2022, depreciation increased to \$3,236 (2021 - \$2,111) while amortization of intangible assets increased to \$1,545 (2021 - \$803).

Share-based compensation

Share-based compensation expense in Q4 2022 was \$178 (Q4 2021 - \$13), representing the fair value of the options amortized over the vesting period of the underlying options during the three months ended December 31, 2022.

Share-based compensation for 2022 was \$797 (2021 - \$433) representing the fair value of the options amortized over the vesting period of the underlying options during 2022. The increase reflects timing of when options are issued to employees, management, and directors.

Financing Costs

Financing costs in Q4 2022 were \$816 (Q4 2021 - \$644) with the increase due to costs associated with the amortization of letters of credit costs associated with larger projects.

For 2022, financing costs increased for the year were \$3,261 (2021 - \$1,657). The increase over the prior year relate to fair value adjust on contingent consideration and the accretion on debt associated with the Kraken Robotics Services acquisition made in July 2021 as well increased letters of credit associated with larger projects.

	Three months ended		Twelve months ended	
	December 31, 2022	December 31, 2021	December 31, 2022	December 31, 2021
Interest on lease liabilities	\$ 75	\$ 96	\$ 327	\$ 357
Letters of credit and other	360	172	1,216	747
Accretion of long-term obligations	109	106	436	196
Fair value adjustment on contingent consideration	272	270	1,282	357
	\$ 816	\$ 644	\$ 3,261	\$ 1,657

Net Income and Adjusted EBITDA

The Company recorded a net loss in Q4 2022 of \$1,270 and a comprehensive net loss of \$1,598, as compared to net income of \$548 and comprehensive net income of \$855 for the same period of prior year. The change over the prior year was driven due to the timing of a large shipment in Q4 2021. Adjusted EBITDA in Q4 2022 was \$931 or an 11% adjusted EBITDA margin compared to an adjusted EBITDA of \$3,476 and adjusted EBITDA margin of 23% in the prior year. The change over the prior was driven by the timing of a large shipment in Q4 2021.

For 2022 the Company recorded a net loss of \$4,243 and a comprehensive loss of \$4,880 compared to a loss of \$3,537 and comprehensive loss of 3,332 for the same period of the prior year. Adjusted EBITDA for the year was \$5,292 or 13% Adjusted EBITDA margin compared to an adjusted EBITDA of \$2,149 or 8% in the prior year. The increase was due to overall growth in our business as well as full year impact of our acquisition of Kraken Robotics Services.

Refer to Non-GAAP section below for further detail.

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2022, the Company had working capital of (\$2,035) (2021 – \$6,365). Cash and cash equivalents as at December 31, 2022 was \$8,265 as compared with \$6,754 at December 31, 2021.

On July 26, 2021, the Company completed a bought deal financing for 20,000,000 units at a price of \$0.50 per Unit for gross proceeds of approximately \$10 million (the “Offering”). Each Unit consisted of one common share of the Company and one-half of one common share purchase warrant (each whole purchase warrant, a “Warrant”). Each Warrant entitles the holder to acquire one common share (a “Warrant Share”) at a price of \$0.60 per Warrant Share for a period of two years following the closing of the Offering, subject to acceleration in certain circumstances.

Net proceeds from the Offering after underwriters’ commission and legal and accounting expenses of \$1,089 related to the offering were \$8,910. Use of proceeds from the Offering included: cash consideration for the acquisition of PGH Capital - \$3,000; partial repayment of PanGeo indebtedness - \$689; transaction costs related to acquisition of PanGeo - \$534 and working capital and general corporate purposes of both Kraken and PanGeo - \$4,687.

During the year ended December 31, 2022, the Company received proceeds of \$132 upon the exercise of 326,250 stock options (December 31, 2021 – proceeds of \$305 upon the exercise of 1,311 stock options). During 2022, the Company received proceeds of \$3 on the exercise of 5,000 common share purchase warrants.

During the twelve months ended December 31, 2022, the Company experienced cash inflows of \$5,237 (2021 – cash outflows \$11,006) from operating activities. Cash outflows from investing activities were \$3,366 versus \$7,244 for 2021. Financing activities realized outflows of \$41 (2021 – cash inflows \$11,923).

Overall, excluding the foreign exchange impact on cash, cash increased by \$1,830 to \$8,265 (2021 – \$6,754).

A commercial bank issued standby letters of credit on behalf of the Company to customers in the amounts of US\$6,215 (C\$8,432), US\$1,960 (C\$2,659) and US\$830 (C\$1,126) on advance guarantees secured by Export Development Canada. The letters of credit expire on October 30, 2023, November 30, 2023 and October 31, 2024, respectively.

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

ACQUISITIONS

Kraken Robotics Services (formerly PanGeo Subsea)

On July 30, 2021 Kraken closed its acquisition of PGH Capital Inc. and its subsidiaries, PanGeo Subsea Inc. and PanGeo Subsea Scotland Limited (collectively with PGH Capital, “PanGeo”). PanGeo specializes in high-resolution 3D acoustic imaging solutions for the sub-seabed. PanGeo’s assets consist primarily of human capital, know-how and equipment comprised mostly of sub bottom imaging units and acoustic imaging units that are used to provide sub-seabed survey services. Effective January 1, 2023 PanGeo Subsea Inc. was renamed Kraken Robotics Services Ltd. And PanGeo Subsea Scotland Limited has been renamed Kraken Robotics Services UK Limited.

The aggregate purchase price for PanGeo is up to \$23 million comprised of the following:

- \$3 million payable on closing;
- 12,068,965 common shares having a value of \$0.58 each and \$7 million in the aggregate issued on closing;
- \$4 million to be paid in cash, plus interest at a rate of 6% per annum, on the second anniversary of the closing date, by non-transferable promissory notes; and
- Up to an aggregate of \$9 million to be paid pursuant to an earn-out on the following terms:
 - an amount equal to 300% of the amount by which certain qualifying revenues in the one-year period immediately following the closing date exceeds \$9,500, up to a maximum payment of \$4,500 (the “First Earn-Out Amount”); and
 - the amount equal to 300% of the amount by which certain qualifying revenues in the two-year period immediately following the closing date exceeds \$21,500, up to a maximum payment of \$4,500 less any amount paid pursuant to the First Earn-Out Amount (the “Second Earn-Out Amount”, and together with the First Earn-Out Amount, the “Earn-Out Amounts”).

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 the 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 (the “TSXV”) 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 Company paid the First Earn-Out Amount of \$4,500 to the sellers of PanGeo Subsea on January 11, 2023. The Company elected to satisfy 50% of the First Earn-Out Amount through the issuance of an aggregate of 4,500,000 common shares (the

“Consideration Shares”) at a deemed price of \$0.50 per Consideration Share and the remaining 50% of the First Earn-out Amount in cash.

The Promissory Notes also provides Kraken with the option, subject to TSXV approval at the time, to satisfy up to 40% of any principal amount owing under the Promissory Notes by issuing Common Shares in accordance with the terms of the PanGeo Agreement.

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. The 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 value of fixed assets and right-of-use assets has been determined based on market comparison and replacement cost techniques. The replacement cost of these assets has been determined and depreciated replacement cost reflects fair value.

OceanVision™ Project

The Company’s OceanVision™ project is focused on the development of a RaaS offering for underwater seabed imagery and mapping. The OceanVision™ project began in the second half of 2019 and was a three-year, \$18.8 million project focused on the development of new marine technologies and products to enable an underwater robotics service business. The goal was to develop a turnkey service solution for ultra-high definition seafloor imaging, mapping and analytics, including simultaneous acquisition of ocean environmental and marine habitat data. Rapid high-throughput data will make it possible to significantly reduce the cost of obtaining high resolution seafloor imaging and mapping allowing end-users to make more informed operational decisions in real-time. The project began in Q3 2019 and has seen Kraken deploy its sensors and unmanned underwater platforms to conduct ultra-high-definition seabed imaging and mapping on the Grand Banks of Newfoundland and other areas of Atlantic Canada. As at December 31, 2022 the initial project has been largely completed and Kraken now has a highly capable services business capable of providing high resolution seabed and sub-seabed imagery to customers in Canada, the US, Europe, and Taiwan.

Financial Contributions Awarded

At December 31, 2022, Kraken had \$14.2 million remaining in grant funding to be offset against R&D activities of which cash of \$2.2 million has been received for projects to be completed during 2023.

Significant components of this remaining funding are as follows:

In August 2021, Kraken Robotics Services was awarded \$2.0 million in funding from the Ocean Supercluster for its development for its GeoScan Wide Area Acoustic Corer of which \$0.6 million has been received.

In November 2021, Kraken was awarded \$2.3 million in funding from the Newfoundland Offshore Oil and Gas Industry Recovery Assistance (OOGIRA) Fund for the development of its Fast Remote 3D Digital Inspection Technology Demonstration project. This project completed in December 2022.

Also in November 2021, Kraken Robotics Services was awarded \$4.8 million in funding from OOGIRA for the development of its GeoTrac project of which \$2.4 million has been received.

In November 2022, Kraken was awarded \$8.0 million in funding to its Brazilian subsidiary to continue development on artificial intelligence, machine learning software and subsea autonomy solutions. No monies on this project were received in 2022.

RISKS AND UNCERTAINTIES

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

Industry specific risks include, but are not limited to:

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

Due to ‘COVID-19’, there has been significant economic volatility and supply chain disruption. In addition, the geopolitical risk currently being experienced may cause continued economic volatility and impact the supply chain. During the year, the Company experienced minor delays in procuring components and conducting sea trials.

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

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, lease liabilities, contingent consideration, and long-term obligations. The Company will make 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 debt or sell assets to reduce debt.

RELATED PARTY TRANSACTIONS

The Company’s related parties are its directors and executive members. Transactions with these related parties are described in Note 21 in the 2022 audited consolidated financial statements of the Company.

FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

As at December 31, 2022, the Company's risk exposures and the impact of the Company's financial instruments are summarized below:

Credit Risk:

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

	December 31, 2022	December 31, 2021
Cash and cash equivalents	\$ 8,265	\$ 6,754
Trade and other receivables	12,221	6,095
Contract assets	4,347	2,699
	<u>\$ 24,833</u>	<u>\$ 15,548</u>

At December 31 2022, 52% of the trade receivables balance was owing from two customers (2021 – 45% of the trade receivables was owing from two customers). At December 31, 2022 the Company had recorded contract liabilities of \$11,817 (2021 – \$4,639).

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. As of December 31, 2022, the Company had a cash balance of \$8,265 (December 31, 2021 - \$6,754). The Company's ability to meet obligations as they come due is dependent on the Company's future generation of cash from operations, ability to obtain financing and to manage contract negotiations with payments to be received in advance to fulfill contracts. There can be no assurance that the Company will generate sufficient cash flows from operations to meet its contractual obligations as they come due. The failure of the Company to generate sufficient cash flows or to obtain additional financing could materially adversely affect the Company's financial condition and results of operations.

Market Risk:

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

(a) Interest rate risk

At December 31, 2022, the Company held \$8,265 in cash and has drawn \$4,309, \$652 and \$1,405 against its operating lines of credit. The drawn operating line of credit bears interest annually at bank prime plus 2.5%, 3.95% and bank prime plus 2.5% respectively, 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, EUR, DKK and BRL. The Company does not use any form of hedging against fluctuations in foreign exchange.

Fair Value:

During the twelve months ended December 31, 2022, there were no transfers between level 1, level 2 and level 3 classified assets and liabilities. The fair values of the Company's financial instruments are considered to approximate the carrying amounts.

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

December 31, 2022	Level 1	Level 2	Level 3
Financial assets at amortized cost:			
Cash and cash equivalents	\$ 8,265	\$ -	\$ -
Trade and other receivables	-	12,221	-
Financial liabilities at amortized cost:			
Bank indebtedness		6,366	
Trade and other payables	-	11,220	-
Long-term obligations	-	6,015	-
Financial liabilities at FVTPL			
Contingent consideration	-	-	8,388

USE OF ESTIMATES AND JUDGEMENTS

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

SUBSEQUENT EVENTS

Subsequent to December 31, 2022, the Company:

- (a) paid the first earnout amount of \$4,500 to the sellers of PanGeo Subsea on January 11, 2023. The Company elected to satisfy 50% of the First Earnout Amount through the issuance of an aggregate of 4,500 common shares (the "Consideration Shares") at a deemed price of \$0.50 per Consideration Share and the remaining 50% of the First Earnout Amount in cash.
- (b) renamed PanGeo Subsea Inc and PanGeo Subsea Scotland Ltd to Kraken Robotics Services Ltd and Kraken Robotics Services UK Ltd respectively.
- (c) amended the value of a standby letter of credit to its customer from the original amount of US\$6,215 (C\$8,432) to US\$3,108 (C\$4,216).

OUTSTANDING SHARE DATA AS AT APRIL 28, 2023:

(a) Authorized and issued share capital:

Class	Par Value	Authorized	Issued Number
Common	No par value	Unlimited	206,051,735

(b) Summary of options outstanding:

Security	Number	Number Exercisable	Exercise Price	Expiry Date
Options	1,200,000	1,200,000	0.57	July 14, 2023
Options	1,000,000	1,000,000	0.63	July 14, 2024
Options	1,000,000	750,000	0.50	July 30, 2026
Options	50,000	-	0.39	November 29, 2026
Options	5,706,250	1,285,000	0.395	May 3, 2027
Options	100,000	33,333	0.39	September 6, 2027
Options	400,000	133,334	0.59	December 7, 2027
Options	75,000	18,750	0.63	January 30, 2028
Options	100,000	25,000	0.58	February 27, 2028
	9,643,750	4,457,918		

ADOPTION OF NEW ACCOUNTING PRONOUNCEMENTS:

- (a) The IASB issued the following standards that have not been applied in preparing these consolidated financial statements as their effective dates fall within annual periods beginning subsequent to the current reporting period. The Company intends to adopt these standards, amendments and interpretations when they become effective.

Classification of Liabilities as Current or Non-current (Amendments to IAS 1)

On January 23, 2020, the IASB issued amendments to IAS 1 Presentation of Financial Statements, to clarify the classification of liabilities as current or non-current. On July 15, 2020 the IASB issued an amendment to defer the effective date by one year. The amendments removed the requirement for a right to defer settlement or roll over of a liability for at least twelve months to be unconditional. Instead such a right must have substance and exist at the end of the reporting period. The amendments are effective for annual periods beginning on or after January 1, 2023. Early adoption is permitted. The extent of the impact of the change has not yet been determined.

Deferred Tax related to Assets and Liabilities arising from a Single Transaction (Amendments to IAS 12)

On May 7, 2021, the IASB issued Deferred Tax related to Assets and Liabilities arising from a Single Transaction (Amendments to IAS 12). The amendments narrow the scope of the initial recognition exemption so that it does not apply to the transactions that give rise to equal and offsetting temporary differences. The amendments are effective for annual periods beginning on or after January 1, 2023. Early adoption is permitted. The extent of the impact of the change has not yet been determined.

Definition of Accounting Estimates (Amendments to IAS 8)

On February 12, 2021, the IASB issued Definition of Accounting Estimates (Amendments to IAS 8). The amendments introduce a new definition for accounting estimates, clarifying that they are monetary amounts in the financial statements that are subject to measurement uncertainty. The amendments also clarify the relationship between accounting policies and accounting estimates by specifying that a company develops an accounting estimate to achieve the objective set out by an accounting policy. The amendments are effective for annual periods beginning on or after January 1, 2023. Early adoption is permitted. The extent of the impact of the change has not yet been determined.

- (b) The following amended IFRS pronouncements were adopted effective January 1, 2022 and had no impact to the Company's financial statements:

Onerous Contracts – Cost of Fulfilling a Contract (Amendments to IAS 37)

On May 14, 2020, the IASB issued Onerous Contracts – Cost of Fulfilling a Contract (Amendments to IAS 37). This amendment clarifies which costs are included as a cost of fulfilling a contract when determining whether a contract is onerous. The amendments were effective for annual periods beginning on or after January 1, 2022 and apply to contracts existing at the date when the amendments are first applied.

Property, Plant and Equipment — Proceeds before Intended Use (Amendments to IAS 16)

On May 14, 2020, the IASB issued Property, Plant and Equipment — Proceeds before Intended Use (Amendments to IAS 16). The amendments clarify that proceeds from selling items before the related item of Property, Plant and Equipment is available for use should be recognised in profit or loss, together with the cost of producing those items. The amendments were effective for annual periods beginning on or after January 1, 2022.

NON-IFRS MEASURES

The Company has included certain non-IFRS financial measures and non-IFRS ratios in this MD&A, including adjusted EBITDA, adjusted EBITDA margin and working capital. Management believes that non-IFRS financial measures and non-IFRS ratios, when supplementing measures determined in accordance with IFRS, provide investors with an improved ability to evaluate the underlying performance of the Company. Non-IFRS financial measures and non-IFRS ratios do not have any standardized meaning prescribed under IFRS, and therefore they may not be comparable to similar measures employed by other companies. This data is intended to provide additional information and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with IFRS.

Adjusted EBITDA and Adjusted EBITDA Margin

The Company believes that, in addition to conventional measures prepared in accordance with IFRS, adjusted EBITDA is useful to securities analysts, investors and other interested parties in evaluating operating performance by presenting the results of the Company on a basis which excludes the impact of certain non-operational items which enables the primary readers of the MD&A to evaluate the results of the Company such that it was operating without certain non-cash and non-recurring items. Adjusted EBITDA is calculated as earnings before interest expense, interest income, income taxes, depreciation and amortization, stock-based compensation expense and non-recurring impact transactions, if any.

Adjusted EBITDA margin is defined as adjusted EBITDA divided by Total Revenue.

	Q4 2022	Q4 2021	2022	2021
Net loss	\$(1,270)	\$548	\$(4,243)	\$(3,537)
Income tax	(1,153)	167	(1,059)	(106)
Financing costs	816	644	3,261	1,657
Loss on disposal of assets	-	-	207	-
Loss on impairment of inventory	397	-	397	-
Foreign exchange (loss) gain	411	173	301	(29)
Share-based compensation	178	13	797	433
Depreciation and Amortization	1,348	1,114	4,781	2,914
EBITDA – excluding restructuring and acquisition costs	727	2,659	4,442	1,332
Restructuring and acquisition costs	204	817	850	817
Impairment charge on inventory	397	-	397	-
Adjusted EBITDA	\$931	\$3,476	\$5,292	\$2,149
Adjusted EBITDA Margin	11%	23%	13%	8%

Gross margin is defined as revenue less cost of total sales. Gross margin percentage is defined as gross margin dividend by total sales.

	Q4 2022	Q4 2021	2022	2021
Revenue	\$8,813	\$14,968	\$40,908	\$25,629
Cost of sales	4,420	8,505	23,871	14,310
Gross margin	4,393	6,463	17,037	11,319
Gross margin percentage	50%	43%	42%	44%

Working capital

Working capital is defined as current assets less current liabilities.

DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

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

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

ADDITIONAL INFORMATION

Selected Annual Information

	Year Ended December 31, 2022 (\$)	Year Ended December 31, 2021 (\$)	Year Ended December 31, 2020 (\$)
Statement of Comprehensive Loss			
Total Revenues	40,908	25,629	12,275
Cost of Sales	23,871	14,310	6,452
Loss from operating activities	(1,136)	(2,015)	(4,451)
Net loss	(4,243)	(3,537)	(5,213)
Basic and diluted loss per share	(0.02)	(0.02)	(0.03)

	Year Ended December 31, 2022 (\$)	Year Ended December 31, 2021 (\$)	Year Ended December 31, 2020 (\$)
Statement of Financial Position			
Total Assets	71,365	65,465	34,820
Total Current Assets	37,827	31,724	25,115
Total Current Liabilities	39,862	25,360	14,696
Total Liabilities	47,710	37,863	18,809
Total Shareholders’ Equity	23,655	27,602	16,011

The Company incurred a loss of \$4.2 million for the year ended December 31, 2022, as compared with a loss of \$3.5 million the year ended December 31, 2021. Share-based payments of \$797 (2021 - \$433) were recorded upon the grant of incentive stock options pursuant to the Company's incentive stock option plan.

Summary of Quarterly Information

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

	Revenue (\$)	Operating activity less share based payments (\$)	Share-based payments (\$)	Net income (loss) (\$)	Comprehensive income (loss) \$	Basic and diluted income (loss) per share (\$)
Q4 2022	8,813	5,411	178	(1,270)	(1,598)	(0.01)
Q3 2022	12,291	4,272	137	(928)	(1,258)	0.00
Q2 2022	14,292	4,561	441	514	560	0.00
Q1 2022	5,512	3,529	41	(2,559)	(2,584)	(0.01)
Q4 2021	15,018	4,918	13	548	855	0.00
Q3 2021	5,061	4,211	189	(2,573)	(2,563)	(0.01)
Q2 2021	1,950	1,378	113	(908)	(935)	(0.01)
Q1 2021	3,601	2,395	118	(604)	(689)	(0.00)

Note: Operating expenses are defined as administrative expenses, R&D costs and depreciation and amortization.

Comparative balance sheet information for 2022 and 2021 is presented below. Total assets in 2021 increased due to the acquisition of PanGeo as well as inventory related for two large contracts. Total liabilities increased in 2021 due to the acquisition of PanGeo and the associated promissory note and contingent consideration.

Comparative quarterly balance sheet information is presented below:

	Total Assets (\$)	Total Current Assets (\$)	Total Current Liabilities (\$)	Total Liabilities (\$)
Q4 2022	71,365	37,827	39,862	47,710
Q3 2022	65,492	34,510	32,654	40,552
Q2 2022	63,444	31,796	25,596	37,383
Q1 2022	63,915	30,313	27,072	38,855
Q4 2021	65,465	31,724	25,360	37,863
Q3 2021	61,797	27,460	19,163	35,064
Q2 2021*	34,639	20,233	15,410	19,849
Q1 2021*	32,037	22,273	12,199	16,445

**The Company has adjusted Q1 2021 and Q2 2021 comparative statements of financial position to correct a misclassification in prepayments in Q1 2021 and Q2 2021 between current assets and non-current assets consistent with the presentation as at December 31, 2021.*

OTHER INFORMATION

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