Kraken Robotics Inc.

Condensed Consolidated Interim Financial Statements

For the three months ended March 31, 2023 and 2022
(Expressed in thousands of Canadian Dollars unless otherwise noted)

(Unaudited)

Q1 Fiscal 2023

KRAKEN

March 31, 2023

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

	March 31, 2023	December 31, 2022
ASSETS		
Current assets:		
Cash and cash equivalents (note 4)	**$ 3,923**	$ 8,265
Trade and other receivables (note 5)	**7,202**	12,221
Contract asset (note 9)	**4,401**	4,347
Current tax receivable	**121**	71
Investment tax credits recoverable	**499**	-
Inventory (note 6)	**13,051**	11,367
Prepayments (note 7)	**2,118**	1,556
	31,315	37,827
Prepayments (note 7)	**17**	23
Property and equipment (note 8)	**20,082**	19,303
Intangible assets	**5,588**	5,973
Goodwill	**7,263**	7,257
Deferred tax asset	**972**	982
TOTAL ASSETS	**$ 65,237**	$ 71,365
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Bank indebtedness (note 11)	**$ 5,159**	$ 6,366
Trade and other payables	**9,721**	11,220
Contract liabilities (note 9)	**11,902**	11,817
Current tax payable	**83**	20
Current portion of long-term obligations (note 12)	**4,928**	5,086
Current portion of lease liabilities	**797**	853
Current portion of contingent consideration	**4,044**	4,500
	36,634	39,862
Long-term obligations (note 12)	**977**	938
Lease liabilities	**2,866**	3,022
Contingent consideration	**-**	3,888
Shareholders' equity:		
Share capital (note 13)	**51,108**	48,839
Contributed surplus	**2,856**	2,700
Accumulated other comprehensive loss	**(536)**	(552)
Deficit	**(28,668)**	(27,332)
	24,760	23,655
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**$ 65,237**	$ 71,365

Commitments (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 thousands of Canadian Dollars except per share and share amounts)

	March 31, 2023	March 31, 2022
Product Revenue (note 9)	**$ 5,328**	**$ 3,726**
Service Revenue (note 9)	**2,250**	**1,786**
	7,578	**5,512**
Cost of sales (note 6)	**3,075**	**3,696**
	4,503	**1,816**
Administrative expenses	**3,360**	**2,542**
Research and development costs	**774**	**480**
Depreciation and Amortization	**1,263**	**1,141**
Share-based compensation (note 13 (c))	**161**	**41**
Investment tax credits recoverable	**(499)**	**(634)**
	5,059	**3,570**
Loss from operating activities	**(556)**	**(1,754)**
Foreign exchange loss	**141**	**56**
Financing costs (note 16)	**553**	**884**
Net loss before income taxes	**(1,250)**	**(2,694)**
Income tax expense (recovery)	**86**	**(135)**
	86	**(135)**
Net loss	**(1,336)**	**(2,559)**
Basic and diluted loss per share	**$ (0.01)**	**$ (0.01)**
Basic and diluted weighted average number of shares outstanding	**205,595,763**	**201,192,985**

KRAKEN

Condensed Consolidated Interim Statements of Net Loss
(Unaudited)
(Expressed in thousands of Canadian Dollars except per share and share amounts)

	March 31, 2023	March 31, 2022
Net loss	**$(1,336)**	**$(2,559)**
Other comprehensive loss		
Items that may be reclassified to profit or loss		
Currency translation adjustment	**16**	**(25)**
Other comprehensive loss	**16**	**(25)**
Comprehensive loss	**$(1,320)**	**$(2,584)**

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

KRAKEN

Condensed Consolidated Interim Statements of Changes in Shareholders' Equity
(Unaudited)
For the Three Ended March 31, 2023 and 2022
(Expressed in thousands of Canadian Dollars except share amounts)

2023	Number of Shares	Share capital (note 13)	Contributed Surplus	Accumulated other comprehensive loss	Deficit	Total
Balance at January 1, 2023	201,524,235	$ 48,839	$ 2,700	$ (552)	$ (27,332)	$ 23,655
Net loss	-	-	-	-	(1,336)	(1,336)
Other comprehensive loss	-	-	-	16	-	16
Transactions with shareholders, recorded directly in equity:						
Issue of common shares on stock option exercises/expired	12,500	8	(3)	-	-	5
Issue of common shares on warrant exercises	15,000	11	(2)	-	-	9
Issue of common shares on contingent consideration	4,500,000	2,250	-	-	-	2,250
Share-based compensation	-	-	161	-	-	161
Shareholders' equity as at March 31, 2023	206,051,735	$ 51,108	$ 2,856	$ (536)	$ (28,668)	$ 24,760

2022	Number of Shares	Share capital (note 13)	Contributed Surplus	Accumulated other comprehensive loss	Deficit	Total
Balance at January 1, 2022	201,192,985	$ 47,416	$ 3,191	$ 85	$ (23,089)	$ 27,603
Net loss	-	-	-	-	(2,559)	(2,559)
Other comprehensive loss	-	-	-	(25)	-	(25)
Transactions with shareholders, recorded directly in equity:						
Issue of common shares on stock option exercises/expired	-	199	(199)	-	-	-
Share-based compensation	-	-	41	-	-	41
Shareholders' equity as at March 31, 2022	201,192,985	$ 47,615	$ 3,033	$ 60	$ (25,648)	$ 25,060

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

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Condensed Consolidated Interim Statements of Cash Flows
(Unaudited)
For the Three Months Ended March 31, 2023 and 2022
(Expressed in thousands of Canadian Dollars)

	March 31, 2023	March 31, 2022
Cash flows provided by (used in) operating activities		
Net loss	**$ (1,336)**	$ (2,559)
Adjustments for items not involving cash:		
Depreciation	**873**	758
Amortization of intangible assets	**390**	383
Share-based payments	**161**	41
Investment tax credit	**(499)**	(634)
Interest on lease liability	**76**	90
Interest on long-term obligations	**15**	16
Accretion expense	**87**	119
Fair value adjustment on contingent consideration	**156**	386
Income tax expense (recovery)	**86**	(135)
Changes in non-cash working capital	**1,311**	(3,506)
Net cash flows (used in) operating activities	**1,320**	(5,041)
Cash flows (used in) investing activities		
Purchase of property and equipment	**(1,588)**	(1,231)
Payment of contingent consideration	**(2,250)**	-
Net cash flows used in investing activities	**(3,838)**	(1,231)
Cash flows provided by (used in) financing activities		
Proceeds from exercise of warrants and options	**14**	-
Payment of principal on leases	**(212)**	(245)
Payment of interest on leases	**(76)**	(90)
Payment of principal long-term obligations	**(366)**	(70)
Payment of interest long-term obligations	**(15)**	(16)
Long term obligations	**183**	62
Bank indebtedness	**(1,207)**	1,168
Net cash flows provided by financing activities	**(1,679)**	809
Net decrease in cash and cash equivalents	**(4,197)**	(5,463)
Effect of foreign exchange on cash	**(145)**	(84)
Cash and cash equivalents at beginning of period	**8,265**	6,754
Cash and cash equivalents at end of period	**$ 3,923**	$ 1,207

1. Corporate Information:

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

The Company's principal business is supplying advanced sonar and optical sensors, batteries, and underwater robotics equipment and services for military and commercial applications.

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, 2022.

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, 2022.

These condensed consolidated interim financial statements were approved by the Board of Directors on May 29, 2023.

(b) Basis of measurement:

These condensed consolidated financial statements have been prepared on a historical cost basis except for contingent consideration which is measured at fair value on each reporting date.

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

(c) Basis of Consolidation

These condensed consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its wholly owned subsidiaries), Kraken Robotic Systems Inc, Ocean Discovery Inc., Kraken Robotik GmbH, Kraken Power GmbH, Kraken Robotics US Inc, Kraken Robotics Denmark ApS, Kraken Robotics Brasil Ltda, PGH Capital Inc, Kraken Robotic Services Limited and Kraken Robotics Services UK Limited. All intercompany balances and revenue and expense transactions have been eliminated on consolidation.

(d) 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:

2. Basis of presentation (continued):

i) Revenue recognition

The Company has multi-year contracts with its customers, and must make judgments about when the Company has satisfied the performance obligations to its 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 are 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 carryforwards, 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 loss and comprehensive 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.

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 judgments in the identification of the acquired assets and assumed liabilities. To determine the fair values of the identified assets and liabilities the Company uses 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.

(Expressed in thousands of Canadian Dollars except share price and share amounts)

2. Basis of presentation (continued):

For example, the acquisition date precedes the closing date if a written agreement provides that the Company obtains control of the acquiree on a date before the closing date. The Company considers all pertinent facts and circumstances in identifying the acquisition date.

3. Adoption of new accounting pronouncements:

The following amended IFRS pronouncements were adopted effective January 1, 2023 and had no impact to the Company's financial statements:

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.

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 is does not apply to the transactions that give rise to equal and offsetting temporary differences.

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.

4. Cash and cash equivalents:

Cash and cash equivalents consist of the following:

	March 31, 2023	December 31, 2021
Cash	$ 3,923	$ 8,265
Short term investments	-	-
	$ 3,923	$ 8,265

5. Trade and other receivables:

Trade and other receivables consist of the following:

	March 31, 2023	December 31, 2022
Trade receivables (net of expected credit loss of $408)	$ 3,727	$ 10,008
Government assistance receivable and other	3,475	2,213
	$ 7,202	$ 12,221

6. Inventory:

As at March 31, 2022, the Company held $13,051 (2022 - $11,367) in inventory**,** consisting of $7,047 (2022 - $8,883) in raw materials and $6,004 (2022 - $2,484) in work-in-progress. Included in cost of sales is inventory costs of $831 (2022 - $1,137). Inventory write-downs consisted of $nil (2022 - $nil).

7. Prepayments:

As at March 31, 2022, the Company had made prepayments of $2,135 (2022 - $1,579). Included in prepayments are advance payment guarantee fees of $209 (2022 – $416) and prepayments towards inventory of $1,383 (2022 - $804). The remaining amount of $543 (2022 - $359) consists of prepayments against insurance, software and other operating expenses.

(Expressed in thousands of Canadian Dollars except share price and share amounts)

8. Property and equipment:

(a) As at March 31, 2023 and December 31, 2022, there were no assets pledged as security.

(b) Reconciliation of property and equipment:

	Furniture, Tools and Equipment	Computer equipment	ROU Asset	Construction in progress	Leasehold improvements	Marine Equipment	Software	Total
Cost								
Balance at January 1, 2022	**$ 2,414**	**$ 1,381**	**$5,648**	**$ 4,359**	**$ 1,759**	**$ 6,658**	**$ -**	**$ 22,218**
Additions	585	130	356	2,694	72	239	695	4,771
Transfers from inventory	403	5				319		727
Transfer	358	-	-	(1,027)	-	670	-	-
Disposals	-	(1)	-	(1,648)	-	-	-	(1,649)
Foreign Exchange	51	2	(45)	-	3	-	-	11
Balance at December 31, 2022	**$ 3,811**	**$ 1,517**	**$5,958**	**$ 4,377**	**$ 1,834**	**$ 7,886**	**$ 695**	**$ 26,078**
Additions	82	128	-	80	21	19	167	497
Disposals	-	-	-	-	-	(15)	-	(15)
Transfers from inventory	-	-	-	1,091	-	-	-	1,091
Foreign Exchange	34	4	36	-	5	-	-	80
Balance at March 31, 2023	**$3,927**	**$1,649**	**$5,994**	**$5,548**	**$1,860**	**$7,890**	**862**	**$27,730**
Accumulated depreciation								
Balance at January 1, 2022	**$ 415**	**$ 122**	**$ 585**	**$ -**	**$ 311**	**$ -**	**$ -**	**$ 1,433**
Depreciation	475	356	1,069	-	309	1,015	12	3,236
Balance at December 31, 2022	**$ 1,201**	**$ 735**	**$ 2,498**	**$ -**	**$ 888**	**$ 1,441**	**12**	**$ 6,775**
Depreciation	136	74	263	-	71	286	43	873
Balance at March 31, 2023	**$1,337**	**$809**	**$2,761**	**-**	**$959**	**$1,727**	**$55**	**$7,648**
Carrying amounts								
At December 31, 2022	**$ 2,610**	**$ 782**	**$ 3,460**	**$ 4,377**	**$ 946**	**$ 6,445**	**$ 683**	**$ 19,303**
At March 31, 2023	**$ 2,590**	**$ 840**	**$ 3,233**	**$ 5,548**	**$ 901**	**$ 6,163**	**$ 807**	**$ 20,082**

(Expressed in thousands of Canadian Dollars except share price and share amounts)

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:

	March 31, 2023	March 31, 2022
Product sales – transferred at a point in time	**$ 3,870**	$ 1,162
Product sales – transferred over time	**1,458**	2,564
Service revenue - transferred over time	**2,250**	1,786
	$ 7,578	$ 5,512

Effective January 1, 2023, the Company changed its revenue recognition for its battery products from point in time to over time using the input cost method. The amount of income recognized in the period from performance obligations satisfied (or partially satisfied) is $416. This is due to changes in the estimate of the stage of completion of construction of battery products. This change in accounting estimate has been made to better reflect the satisfaction of the performance obligations over time of the project.

Refer to note 18 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 contract assets 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.

As at March 31, 2023, contract liabilities, which represents payments received from contracts with customers for which the criteria for revenue recognition has not yet been met, was $11,902 (2022 - $11,817).

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

	Contract assets
Opening balance – January 1, 2023	$ 4,347
Increase in unbilled from revenue recognized	292
Decrease in unbilled from transfer to trade receivables and other adjustments	(238)
Ending Balance – March 31, 2023	**$ 4,401**

	Contract liabilities
Opening balance – January 1, 2023	$ 11,817
Increase in contract liabilities from payments received, excluding revenue recognized	2,427
Decreases in contract liabilities from revenue recognized	(2,342)
Ending Balance – March 31, 2023	**$ 11,902**

(Expressed in thousands of Canadian Dollars except share price and share amounts)

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:

	March 31, 2023	December 31, 2022
Cash and cash equivalents	$ 3,923	$ 8,265
Trade and other receivables	7,041	12,221
Contract assets	4,401	4,347
	$ 15,365	$ 24,833

Credit risk is defined as the Company's 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. The Company is exposed to credit risk on accounts receivable and certain other assets through normal commercial activities. The Company are also exposed to credit risk through the normal treasury activities on cash and cash equivalents. Credit risks arising from normal commercial activities are managed with regards to customer credit risk. The Company's customers are mainly established companies as well as government agencies, which facilitates risk assessment and monitoring. In addition, the Company typically receives substantial advance payments for contracts with customers. The Company does 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.

Trade receivables include an expected credit loss. As of March 31, 2023, the amount is $408 (2022 - $224).

Revenues from the top three customers represented 69% of the Company's revenue in the period ended March 31, 2023 (2022 – top three customers represented 75% of revenue). At March 31, 2023, 66% of the trade receivables balance were owing from two customers (2022 – 52% of trade receivables was owing from two customers). At March 31, 2023, the Company had recorded contract liabilities of $11,902 (2022 – $11,817).

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. As of March 31, 2023, the Company had a cash balance of $3,293 (December 31, 2022 - $8,265). 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.

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

	0-12 months	1-2 years	2-4 years	Beyond four years
Bank indebtedness	$ 5,159	$ -	$ -	$ -
Trade and other payables	9,721	-	-	-
Long-term obligations	4,928	311	556	110
Contingent consideration	4,044	-	-	-
	$ 23,852	$ 311	$ 556	$ 110

(Expressed in thousands of Canadian Dollars except share price and share amounts)

10. Financial instruments (continued):

Market Risk:

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

(a) Interest rate risk

At March 31, 2023, the Company held $3,923 in cash and has drawn $3,112, $632 and $1,415 against its operating lines of credit. The drawn operating lines of credit bear interest annually at bank prime plus 2.5%, 3.95% and bank prime plus 2.5% respectively, payable monthly. An increase (decrease) of 1,000 basis points in the interest rate would have increased (decreased) the Company's net loss by approximately $9.

(b) Foreign currency risk

The Company's exposure to foreign currency risk is limited to sales and certain purchases 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:

	March 31, 2023	December 31, 2022
Financial liabilities denominated in foreign currency:		
Trade and other payables USD	$ 2,459	$ 581
Trade and other payables GBP	754	1,381
Trade and other payables EUR	421	1,203
Trade and other payables DKK	10	120
Trade and other payables BRL	1,477	241
Long-term debt EUR	867	1,016
Bank indebtedness EUR	429	377
Financial assets denominated in a foreign currency:		
Trade and other receivables USD	281	4,697
Trade and other receivables GBP	1,453	2,072
Trade and other receivables EUR	1,328	473
Trade and other receivables DKK	193	6
Trade and other receivables BRL	361	21

For the period ended March 31, 2023, with other variables remaining constant, a 10% increase (decrease) in the exchange rate of the US dollar, British Pound, Euro, Brazilian Real and Danish Krone to the Canadian dollar exchange rate would have increased (decreased) the Company's net loss by approximately $816 (2022 - $981).

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).

(Expressed in thousands of Canadian Dollars except share price and share amounts)

10. Financial instruments (continued):

The carrying values of cash and cash equivalents, trade and other receivables, 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 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 the Company at March 31, 2023. 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 approximates the amortized cost. For the fair value of contingent consideration, changes to the risk-adjusted discount rate of 1% at March 31, 2023, while holding other inputs constant would have the following impact. An increase (decrease) in discount rate would have increased (decreased) the Company's net loss by approximately $23 and ($23) respectively.

The following table shows a reconciliation from the opening balances to the closing balances of level 3 fair values:

	Contingent Consideration
Opening balance – January 1, 2023	$ 8,388
Payment of contingent consideration in cash	(2,250)
Payment of contingent consideration in shares	(2,250)
Fair value adjustment of contingent consideration	156
Ending Balance – March 31, 2023	**$ 4,044**

11. Bank indebtedness:

At March 31, 2023, the Company had available a $4,500 line of credit for general operating purposes (the "operating line"). The operating line bear interest at the bank's prime rate plus 2.5%, payable monthly. As at March 31, 2023, a total of $3,112 (December 31, 2022 - $4,309) was drawn against this facility. Security for the operating line is accounts receivable and inventory. Kraken Power has a €500 line of credit for general operating purposes. The line bear interest of 3.95%, payable monthly. As at March 31, 2022 a total of €429 ($632) (December 31, 2022 - $652 (€450)) was drawn against this facility. The line of credit is guaranteed by a German regional economic development organization. Additionally, Kraken Robotic Services had available a $1,500 line of credit for general operating purposes. The operating line bear interest at the bank's prime rate plus 2.5%, payable monthly. As at March 31, 2023, a total of $1,415 (December 31, 2022 - $1,405) was drawn against this facility.

(Expressed in thousands of Canadian Dollars except share price and share amounts)

12. Long-term obligations:

	March 31, 2023	December 31, 2022
Long-term note payable in the amount of €200 with a German regional economic development organization, due June 30, 2023, unsecured and bearing interest at 8.5% per annum.	$ 295	$ 560
Loan, secured by equipment, bearing interest at 1.5%, in the amount of €89 repayable in equal installments of €1,306 over 72 months, and maturing on December 31, 2026.	82	86
Loan, secured by equipment and infrastructure, bearing interest at 1.23% in the amount of €875 repayable in equal installments over 67 months, and maturing on September 30, 2026.	902	979
Promissory Note on acquisition of Kraken Robotic Services, in the amount of $4,000 bearing interest at 6% per annum, due July 30, 2023.	4,374	4,287
Loan, non-interest bearing from Atlantic Canada Opportunities Agency (ACOA), currently in the amount of $112 with a maximum of $295 available, repayable in equal installments beginning June 1, 2023.	252	112
	5,905	6,024
Less current portion of long-term obligations	(4,928)	(5,086)
	$ 977	$ 938

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

Opening balance – January 1, 2023	$ 6,024
Proceeds from long-term obligations	183
Payment of principle	(366)
Payment of interest	(15)
Accretion expense	87
Foreign Exchange	(8)
Ending Balance – March 31, 2023	$ 5,905

(Expressed in thousands of Canadian Dollars except share price and share amounts)

13. Share capital:

Authorized: Unlimited number of common shares

See the condensed consolidated statements of changes in shareholders' equity for a summary of changes in Share capital and Contributed surplus for the period ended March 31, 2023 and the year ended December 31, 2022.

(a) Share purchase warrants

At March 31, 2023 and December 31, 2022, the following share purchase warrants were outstanding:

Expiry Date	Exercise Price	March 31, 2022	December 31, 2022	Weighted Average Remaining Contractual Life
July 26, 2023	$0.60	9,980,000	9,995,000	0.32 years
	$0.60	**9,980,000**	**9,995,000**	**0.32 years**

(b) Share options

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

The following options were outstanding as at March 31, 2023 and December 31, 2022:

	March 31, 2023		December 31, 2022	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Opening balance	9,468,750	$ 0.46	8,358,333	$ 0.57
Granted	175,000	0.60	6,830,000	0.41
Exercised	(12,500)	0.395	(326,250)	0.41
Expired	-	-	(5,393,333)	0.56
Ending balance	9,631,250	$ 0.46	9,468,750	$ 0.46
Options exercisable	4,457,917	$ 0.52	4,380,834	$ 0.52

Weighted Average Exercise Price	Expiry Date	Number Outstanding	Number Exercisable	Weighted Average Remaining Contractual Life
0.57	July 14, 2023	1,200,000	1,200,000	0.29 years
0.63	July 14, 2024	1,000,000	1,000,000	1.29 years
0.50	July 30, 2026	1,000,000	750,000	3.33 years
0.39	November 29, 2026	50,000	-	3.67 years
0.39	May 3, 2027	5,706,250	1,297,500	4.09 years
0.37	September 6, 2027	100,000	33,333	4.44 years
0.59	December 7, 2027	400,000	133,334	4.69 years
0.63	January 30, 2028	75,000	18,750	4.84 years
0.58	February 27, 2028	100,000	25,000	4.92 years
$ 0.464		**9,631,250**	**4,457,917**	**3.51 years**

(Expressed in thousands of Canadian Dollars except share price and share amounts)

13. Share capital (continued):

(c) Share-based compensation

During the period ended March 31, 2023, the Company recorded share-based compensation totaling $161 (2022 - $41), which was expensed in operations with a corresponding increase in contributed surplus.

The weighted average share price at the date of exercise for share options exercised during the period ended March 31, 2023 was $0.395 (2022 - $0.405). The fair values of the options granted were estimated using the Black-Scholes option pricing model with the following assumptions:

	Three Months ended March 31, 2023	Year ended December 31, 2022
Risk-free interest rate	3.01% to 4.21%	0.54% to 3.52%
Expected life of options	3.5 years	3.61 years
Expected volatility	48.2% to 68.2%	51.5% to 66.7%
Weighted average fair value per option	$0.17 to $0.34	$0.12 to $0.33
Dividend yield	Nil	Nil

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

15. Government assistance:

During the three months ended March 31, 2023, the Company received government assistance, excluding the OceanVision project, in the amount of $12 (2022 - $936). Government Assistance has been classified as a reduction to Cost of Sales of $nil (2022 - $61), Research & Development expense of $nil (2022 – $664), Administrative expense of $12 (2022 - $76) and Construction in Process of $nil (2022 - $135).

The financial statements reflect a cost reimbursement under Kraken's OceanVision project during the three months ended March 31, 2023, including $nil (2022 – $177) in reimbursements from the Ocean SuperCluster and $nil (2022 – $244) in reimbursements by funding partners. Assistance related to the OceanVision project has been classified as a reduction to Research & Development expense of $nil (2022 – $334), Administrative expense $nil (2022 – $36), and Construction in progress of $nil (2022 – $51).

The financial statements also reflect a cost reimbursement under Kraken's Brazilian subsidiary R&D project during the three months ended March 31, 2023 in the amount of $347. This reimbursement has been classified as a reduction to Research and Development expense of $347 (2022 - $nil).

(Expressed in thousands of Canadian Dollars except share price and share amounts)

16. Financing costs:

	March 31, 2023	March 31, 2022
Interest on lease liabilities	**$ 76**	$ 90
Letters of credit and other	**234**	289
Accretion on long-term obligations	**87**	119
Fair value adjustment of contingent consideration	**156**	386
	$ 553	$ 884

17. Seasonality:

The Company's Services segment is subject to seasonal fluctuations because of weather conditions in northern geographic regions as operations can be adversely affected by winter conditions, which occur in January to February, as well as November and December. This segment can have lower revenues and results during these periods.

18. Segmented information:

As of January 1, 2023 the Company has changed its internal organization to operate in two new reportable operating segments, being: 1) “Products” which is the design, manufacture and sale of equipment including underwater vehicle platforms, Synthetic Aperture Sonar and subsea power equipment; 2) “Services” which is the provision of services for underwater sonar and laser scanner sensor equipment and underwater vehicle platforms.

The following tables present the operations of the Company’s reportable segments as at and for the three months ended March 31, 2023 and restated comparatives for March 31, 2022:

March 31, 2023	**Products**	**Services**	**Consolidated**
Revenue	$ 5,328	$ 2,250	$ 7,578
Cost of Goods sold and expenses	$ 5,856	$ 2,972	$ 8,828
Segment loss	$ (528)	$ (722)	$ (1,250)
Segment capital expenditures	$ 1,565	$ 23	$ 1,588

March 31, 2022	**Products**	**Services**	**Consolidated**
Revenue	$ 3,726	$ 1,786	$ 5,512
Cost of Goods sold and expenses	$ 5,307	$ 2,899	$ 8,206
Segment loss	$ (1,581)	$ (1,113)	$ (2,694)
Segment capital expenditures	$ 897	$ 334	$ 1,231

(Expressed in thousands of Canadian Dollars except share price and share amounts)

18. Segmented information (continued):

Revenues from external customers are attributed to geographic areas based on the location of the contracting customers.

The following table sets forth external revenue by geographic areas:

	Three months ended March 31, 2023	Three months ended March 31, 2022
Total revenues:		
Canada	277	502
United States	4,565	1,056
Europe	1,898	3,954
Australia	838	-
	$ 7,578	$ 5,512

19. Commitments:

(a) A commercial bank issued standby letters of credit on behalf of the Company to customers in the amount of US$3,108 (C$4,210), US$1,960 (C$2,655) and US$830 (C$1,124) 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.

(b) 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 at March 31, 2023 is $45 (2022 - $13).