# Kraken Sonar Inc.

**(formerly Anergy Capital Inc.)**

## Condensed Consolidated Interim Financial Statements

**For the three months ended March 31, 2017 and 2016**
**(Expressed in Canadian Dollars)**

**(Unaudited)**

## Q1 Fiscal 2017

**KRAKEN**

**March 31, 2017**

**CONTENTS**

KRAKEN

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

| | March 31, 2017 | December 31, 2016 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash | **$ 51,854** | $ 85,650 |
| Trade and other receivables (note 5) | **719,129** | 550,696 |
| Note receivable (note 6) | **393,287** | - |
| Inventory (note 7) | **790,799** | 1,116,429 |
| Prepayments | **22,269** | 19,123 |
| | **1,977,338** | 1,771,898 |
| Investment (note 6) | **-** | 157,320 |
| Property and equipment, net | **291,293** | 259,360 |
| **TOTAL ASSETS** | **$ 2,268,631** | $ 2,188,578 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIENCY)** | | |
| Current Liabilities: | | |
| Bank indebtedness (note 9) | **$ 246,208** | $ 150,000 |
| Trade and other payables | **1,656,958** | 1,266,352 |
| Deferred revenue | **217,144** | - |
| | **2,120,310** | 1,416,352 |
| Shareholders' equity (deficiency): | | |
| Share capital (note 11) | **4,173,470** | 4,086,270 |
| Contributed surplus | **1,654,763** | 1,647,963 |
| Deficit | **(5,679,912)** | (4,962,008) |
| | **148,321** | 772,225 |
| **TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIENCY)** | **$ 2,268,631** | $ 2,188,578 |

Going concern (note 2)
Subsequent events (note 17)

**On Behalf of the Board:**

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

The accompanying notes form part of the consolidated financial statements.

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

| | March 31, 2017 | March 31, 2016 |
|---|---|---|
| Product sales | **$ 246,498** | $ 710,690 |
| | **246,498** | 710,690 |
| Cost of sales (note 13) | **169,367** | 74,331 |
| | **77,131** | 636,359 |
| Administrative expenses | **428,601** | 304,099 |
| Research and development costs | **475,195** | 110,128 |
| Share-based payments (note 11(c)) | **39,000** | 70,100 |
| Employee costs | **830,123** | 527,191 |
| Government assistance (note 14) | **(284,674)** | (285,699) |
| | **1,488,245** | 725,819 |
| **Loss from operating activities** | **(1,411,114)** | (89,460) |
| Foreign exchange loss (gain) | **(1,498)** | 28,125 |
| Financing costs – line of credit (note 9) | **2,088** | 11 |
| Gain on sale of investment (note 6) | **(380,178)** | - |
| Unrealized gain on sale of investment (note 6) | **(313,622)** | - |
| **Net loss, being comprehensive loss** | **$ (717,904)** | **$ (117,596)** |
| Basic and diluted loss income per share | **$ (0.01)** | $ (0.00) |
| Basic and diluted weighted average number of shares outstanding | **78,541,340** | 71,068,214 |

The accompanying notes form part of the consolidated financial statements.

KRAKEN

**Condensed Consolidated Interim Statements of Changes in Shareholders' Equity (Deficiency)**
**(Unaudited)**
**(Expressed in Canadian Dollars)**

| **2017** | Number of Shares | Share capital (note 10) | Contributed Surplus | Deficit | Total |
|---|---|---|---|---|---|
| Balance at January 1, 2017 | **78,519,414** | **$ 4,086,270** | **$ 1,647,963** | **$ (4,962,008)** | **$ 772,225** |
| Net loss | - | - | - | **(717,904)** | **(717,904)** |
| Transactions with shareholders, recorded directly in equity: | | | | | |
| Issue of common shares on warrant exercises | **366,666** | **87,200** | **(32,200)** | **-** | **55,000** |
| Share-based compensation | - | **-** | **39,000** | **-** | **39,000** |
| **Shareholders' equity (deficiency) as at March 31, 2017** | **78,886,080** | **$ 4,173,470** | **$ 1,654,763** | **$ (5,679,912)** | **$ 148,321** |

| **2016** | Number of Shares | Share capital (note 10) | Contributed Surplus | Deficit | Total |
|---|---|---|---|---|---|
| Balance at January 1, 2016 | **71,068,214** | **$ 3,072,426** | **$ 1,437,710** | **$ (3,541,833)** | **$ 968,303** |
| Net loss | - | **-** | - | **(117,596)** | **(117,596)** |
| Transactions with shareholders, recorded directly in equity: | | | | | |
| Share-based compensation | - | **-** | **70,100** | **-** | **70,100** |
| **Shareholders' equity (deficiency) as at March 31, 2016** | **71,068,214** | **$ 3,072,426** | **$ 1,507,810** | **$ (3,659,429)** | **$ 920,807** |

KRAKEN

**Condensed Consolidated Interim Statements of Cash Flows**
**(Unaudited)**
**(Expressed in Canadian Dollars)**

| | March 31, 2017 | March 31, 2016 |
|---|---|---|
| **Cash flows used in operating activities** | | |
| Net loss | $ **(717,904)** | $ (117,595) |
| **Adjustments for items not involving cash:** | | |
| Depreciation | **19,103** | 12,136 |
| Share-based payments | **39,000** | 70,100 |
| Gain on sale of investment | **(380,178)** | - |
| Unrealized gain on sale of investment | **(313,622)** | - |
| Changes in non-cash working capital (note 15) | **761,800** | (517,060) |
| **Net cash flows used in operating activities** | **(591,801)** | (552,419) |
| **Cash flows from (used in) investing activities** | | |
| Proceeds on disposal of investment (note 6) | **457,832** | - |
| Purchase of property, plant and equipment | **(51,001)** | (26,012) |
| Increase in bank indebtedness | **96,208** | 4,000 |
| | **503,039** | (22,012) |
| **Cash flows from (used in) financing activities** | | |
| Proceeds from exercise of warrants | **55,000** | - |
| Increase (decrease) in loans to (from) a director | **-** | (2,648) |
| | **55,000** | (2,648) |
| **Net decrease in cash** | **(33,762)** | (577,079) |
| **Effect of foreign exchange on cash** | **(34)** | - |
| **Cash at beginning of period** | **85,650** | 771,940 |
| **Cash at end of period** | $ **51,854** | $ 194,861 |

The accompanying notes form part of the consolidated financial statements.

## 1. Corporate Information:

Kraken Sonar Inc. (“Kraken” or the “Company”) (formerly Anergy Capital Inc.) 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 Suite 700, 595 Burrard Street, PO Box 49290, Vancouver, BC V7X 1S8.

The Company was incorporated as Anergy Capital Inc. (“Anergy”) under the Business Corporations Act, British Columbia and was classified as a Capital Pool Company (“CPC”) as defined under Policy 2.4 of the TSX Venture Exchange. The principal business of the Company at that time was the identification of an asset or business acquisition that would meet the requirements as a Qualifying Transaction (“QT”) as defined in Policy 2.4.

On February 18, 2015 the Company closed its Qualifying Transaction pursuant to an agreement between Anergy and Kraken Sonar Systems Inc., and Anergy changed its name to Kraken Sonar Inc. (together, “the Company”).

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

## 2. Going concern:

These condensed consolidated interim financial statements have been prepared on a going concern basis, which assumes the Company will continue in operation for the foreseeable future and be able to realize its assets and discharge its liabilities and commitments in the normal course of business. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period. Management is aware, in making its assessment, of material uncertainties related to events or conditions that cast significant doubt upon the Company’s ability to continue as a going concern, as the Company experienced significant losses and negative cash flows from operations since inception and at March 31, 2017 has a deficit of $5,679,912 (December 31, 2016 - $4,962,008).

The ability of the Company to continue as a going concern and to realize its assets and discharge its liabilities when due is dependent on its ability to achieve and maintain profitable operations and positive cash flows from operations in the future and/or upon securing additional financing. The timing and availability of additional financing will be determined largely by the performance of the Company and market conditions and there is no certainty that the Company will be able to raise funds as they are required in the future.

These condensed consolidated interim financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis was not appropriate, then adjustments would be necessary in the carrying amount of assets and liabilities, the reported revenues and expenses, and the statement of financial position classifications used.

## 3. Basis of presentation:

(a) Statement of compliance:

These condensed consolidated interim financial statements, including comparatives, have been prepared in accordance with IAS 34, Interim Financial Reporting as issued by the International Accounting Standards Board (“IASB”). These financial statements were prepared using the same accounting policies and methods of computation, and are subject to the same use of estimates and judgments, as the Company’s consolidated financial statements for the year ended December 31, 2016.

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, 2016 prepared in accordance with IFRS as issued by the IASB.

These consolidated financial statements were approved by the Board of Directors on May 30, 2017.

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

(b) Reclassification of comparative figures

Research and development costs previously included in Cost of Goods Sold have been presented as a separate expense item on the statement of net loss and comprehensive loss. In addition, government assistance that was previously netted against employee costs has also been presented as a separate line item within operating expenses. Comparative figures for the three months ended March 31, 2016 have been reclassified to conform to the presentation adopted for the current period.

**4. Significant accounting policies:**

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

The following standards and amendments to existing standards have been adopted by the Company effective January 1, 2017:

***Amendments to IAS 7, Statement of Cash Flows:***

In January 2016, the IAS issued amendments to IAS 7, Statement of Cash Flows. The amendments require disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flow and non-cash changes. One way to meet this new disclosure requirement is to provide a reconciliation between the opening and closing balances for liabilities from financing activities. These amendments became effective for annual periods beginning on or after January 1, 2017 and the Company will adopt these changes for the 2017 annual financial statements.

***Amendments to IAS 12, Income Taxes:***

In January 2016, the IASB issued amendments to IAS 12, Income Taxes. The amendments clarify that the existence of a deductible temporary difference depends solely on a comparison of the carrying amount of an asset and its tax base at the end of the reporting period, and is not affected by possible future changes in the carrying amount or expected manner of recovery of the asset. The amendments also clarify the methodology to determine the future taxable profits used for assessing the utilization of deductible temporary differences. The amendments became effective for annual periods beginning on or after January 1, 2017 and adoption of the amendments did not have a material impact on the consolidated financial statements.

(b) Future changes in accounting policies:

A number of new standards, and amendments to standards and interpretations under IFRS, are not yet effective for the year ended December 31, 2016, and have not been applied in preparing these consolidated financial statements.

***IFRS 15, Revenue from Contracts with Customers:***

The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimated and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized. The Company intends to adopt IFRS 15 in its consolidated financial statements for the annual period beginning on January 1, 2018. The extent of the impact of adoption of the standard has not yet been determined.

## 4. Significant accounting policies (continued):

(b) Future changes in accounting policies (continued):

***IFRS 9, Financial Instruments:***

IFRS 9, Financial Instruments, will replace IAS 39, Financial Instruments: Recognition and Measurement, and some of the requirements of IFRS 7, Financial Instruments: Disclosures. The Objective of IFRS 9 is to establish principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows. The IASB has determined the revised effective date for IFRS 9 will be for annual periods beginning on or after January 1, 2018. The Company will evaluate the impact of the change to the consolidated financial statements based on the characteristics of financial instruments outstanding at the time of adoption.

***IFRS 16, Leases:***

In January 2016, the IASB issued IFRS 16 *Leases*. This standard introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. This standard substantially carries forward the lessor accounting requirements of IAS 17, while requiring enhanced disclosures to be provided by lessors. Other areas of the lease accounting model have been impacted, including the definition of a lease. Transitional provisions have been provided. The new standard is effective for annual periods beginning on or after January 1, 2019. The Company is currently evaluating the impact of this standard on the consolidated financial statements.

***Amendments to IFRS 2, Share-based Payments:***

In June 2016, the IASB issued amendment to IFRS 2, Shares-based Payments, clarifying how to account for certain types of share-based payment transactions. The amendments provide requirements on the accounting for a) the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments; b) share-based payment transactions with a net settlement feature for withholding tax obligations; and c) a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled. The amendments apply for annual periods beginning on or after January 1, 2018. As a practical simplification, the amendments can be applied prospectively. The Company intends to adopt the amendments to IFRS 2 in its financial statements for the annual period beginning on January 1, 2018. The extent of the impact of adoption of the standard has not yet been determined.

## 5. Trade and other receivables:

Trade and other receivables consist of the following:

| | March 31, 2017 | December 31, 2016 |
|---|---|---|
| Trade receivables | $ 504,968 | $ 248,386 |
| Unbilled accounts receivable | 153,729 | 153,729 |
| Government assistance receivable and other | 60,432 | 148,581 |
| | $ 719,129 | $ 550,696 |

## 6. Investment

During 2016, the Company had entered into an agreement with Square Robot, Inc., a private US-based company, in respect of the co-design of small robots for large above ground storage tanks. Pursuant to the agreement, as at December 31, 2016, the Company had invested CAD$157,320 (US$120,000) in the company.

| | March 31, 2017 | | December 31, 2017 | |
|---|---|---|---|---|
| | **USD** | **CAD** | **USD** | **CAD** |
| Investment | $ - | $ - | $ 120,000 | $ 157,320 |

During the first quarter of Fiscal 2017, the Company disposed of its investment in Square Robot Inc., a non-core asset, for consideration of US$700,000, half of which was received on February 28, 2017, with the balance in the form of a note receivable due no later than June 27, 2017. A gain of $380,178 was realized upon the sale of the investment. Subsequent to March 31, 2017, the Company reduced the amount owing from $458,835 (US$350,000) to $393,287 (US$300,000) in exchange for early settlement of the note receivable. An unrealized gain of $313,622 was recorded in respect of the proceeds receivable upon extinguishment of the note (note 17(d)).

## 7. Inventory

As at March 31, 2017, the Company held $790,799 (2016 - $1,116,429) in inventory, consisting of $790,799 (2016 - $1,116,429) in raw materials and $Nil (2016 - $Nil) in work-in-progress.

## 8. 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, 2017 | December 31, 2016 |
|---|---|---|
| Cash | $ 51,854 | $ 85,650 |
| Trade and other receivables | 719,129 | 550,696 |
| Note receivable | 393,287 | - |
| Share subscription receivable | 76,833 | 76,833 |
| | $ 1,241,103 | $ 713,179 |

The Company manages credit risk by holding the majority of its cash with high quality financial institutions in Canada, where management believes the risk of loss to be low.

Revenues from the top customer represented 100% of the Company’s revenue in the three months ended March 31, 2017 (2016 – top 3 customers represented 97% of revenue). At March 31, 2017, 99% of the trade receivables balance was owing from 2 customers (2016 – 72% of the trade receivables was owing from 3 customers). At March 31, 2017, the Company had recorded deferred revenues of $217,144 (2016 – $Nil).

The share subscription receivables relate to the exercise price for options issued to employees and subsequently exercised, and are recorded as a reduction of share capital.

## 8. Financial instruments (continued):

**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 March 31, 2017, the Company had a cash balance of $51,854 (December 31, 2016 - $85,650) to settle current liabilities of $2,120,310 (December 31, 2016 - $1,416,353). Refer to notes 2 and 17(a) for discussion of going concern risk and private placement financing subsequent to March 31, 2017.

**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, 2017, the Company has cash balances of $51,854 and has drawn $246,208 against its line of credit. The Company is not exposed to any significant interest rate risk.

(a) Foreign currency risk

The Company's exposure to foreign currency risk is limited to US$ sales and certain purchases of inventory. 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, 2017** | **December 31, 2016** |
|---|---|---|
| Financial liabilities denominated in foreign currency: | | |
| Trade and other payables USD | $ 91,415 | $ 87,295 |
| Trade and other payables GBP | 67,640 | 65,196 |
| Trade and other payables EUR | 76,126 | 1,247 |
| Financial assets denominated in a foreign currency: | | |
| Trade and other receivables USD | 250,000 | 378,856 |

For the three months ended March 31, 2017, with other variables remaining constant, a 10% increase (decrease) in the US dollar to Canadian dollar exchange rate would have increased (decreased) the Company's net loss by approximately $67,600 (2016 - $11,300).

**Fair Value:**

During the three months ended March 31, 2017, 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:

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

**Fair Value (continued):**

| **March 31, 2017** | **Level 1** | **Level 2** | **Level 3** |
|---|---|---|---|
| Financial assets classified as loans and receivables: | | | |
| Cash | $ 51,854 | $ - | $ - |
| Trade and other receivables | - | 719,129 | - |
| Note receivable | - | 393,287 | - |
| Share subscription receivables | - | 76,833 | - |
| Financial liabilities at amortized cost: | | | |
| Bank indebtedness | - | 246,208 | - |
| Trade and other payables | - | 1,656,958 | - |
| Deferred revenue | - | 217,144 | - |

| **December 31, 2016** | **Level 1** | **Level 2** | **Level 3** |
|---|---|---|---|
| Financial assets classified as loans and receivables: | | | |
| Cash | $ 85,650 | $ - | $ - |
| Trade and other receivables | - | 550,696 | - |
| Share subscription receivables | - | 76,833 | - |
| Financial liabilities at amortized cost: | | | |
| Bank indebtedness | - | 150,000 | - |
| Trade and other payables | - | 1,266,352 | - |

**9. Bank indebtedness:**

At March 31, 2017, the Company had a $250,000 line of credit for general operating purposes (the “operating line”). The operating line bears interest at the bank’s prime rate plus 2%, payable monthly. As at March 31, 2017, a total of $246,208 (December 31, 2016 - $150,000) was drawn against this facility.

**10. Related party transactions:**

Included in share subscription receivables at March 31, 2017 is $60,608 (December 31, 2016 - $60,608) owing from key management personnel.

**11. Share capital:**

Authorized: Unlimited number of common shares

See the consolidated statements of changes in shareholders’ equity (deficiency) for a summary of changes in Share capital and Contributed surplus for the periods ended March 31, 2017 and 2016.

(a) Share purchase warrants

On February 18, 2015, as part of the RTO (note 1) the lenders of a $2,109,500 bridge loan to Kraken Sonar Systems Inc. converted the indebtedness into 14,063,326 common shares in the Company. On conversion of the bridge loan, the lenders also received share purchase warrants convertible into the same number of shares exercisable at a price of $0.15 per warrant for a period of thirty-six (36) months from the date of issuance.

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

## 11. Share capital (continued):

(a) Share purchase warrants (continued)

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

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

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

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

Share purchase warrant transactions are summarized for the periods ending March 31, 2017 and December 31, 2016:

| | **Three months ended March 31, 2017** | | | **Year ended December 31, 2016** | | |
|---|---|---|---|---|---|---|
| | Number of Warrants | Weighted Average Exercise Price | | Number of Warrants | Weighted Average Exercise Price | |
| Opening balance | 17,759,759 | $ | 0.18 | 14,841,103 | $ | 0.16 |
| Issued for private placement | - | | - | 3,579,767 | | 0.30 |
| Issued for debt settlement | - | | - | 116,666 | | 0.30 |
| Warrants exercised | (366,666) | | 0.15 | (58,333) | | 0.15 |
| Warrants expired | - | | - | (719,444) | | 0.30 |
| Ending balance | 17,393,093 | $ | 0.18 | 17,759,759 | $ | 0.18 |
| Warrants exercisable | 17,393,093 | $ | 0.18 | 17,759,759 | $ | 0.18 |

At March 31, 2017 and December 31, 2016, the following share purchase warrants were outstanding:

| **Expiry Date** | **Exercise Price** | **March 31, 2017** | **December 31, 2016** | **Weighted Average Remaining Contractual Life** |
|---|---|---|---|---|
| February 18, 2018 | $0.15 | 13,696,660 | 14,063,326 | 0.89 years |
| August 12, 2018 | $0.30 | 3,579,767 | 3,579,767 | 1.37 years |
| August 22, 2018 | $0.30 | 116,666 | 116,666 | 1.39 years |
| | **$0.16** | **17,393,093** | **17,759,759** | **1.22 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.

## 11. Share capital (continued):

(b) Share options (continued)

The following options were outstanding as at March 31, 2017 and December 31, 2016:

| | **March 31, 2017** | | **December 31, 2016** | |
|---|---|---|---|---|
| | Number of Options | Weighted Average Exercise Price | Number of Options | Weighted Average Exercise Price |
| Opening balance | 4,960,000 | $ 0.21 | 4,260,000 | $ 0.23 |
| Granted | 250,000 | 0.17 | 900,000 | 0.15 |
| Expired | (200,000) | 0.15 | (200,000) | 0.15 |
| Ending balance | 5,010,000 | $ 0.21 | 4,960,000 | $ 0.21 |
| Options exercisable | 2,743,333 | $ 0.22 | 2,226,666 | $ 0.22 |

All share options had exercise prices that were higher or equal to market prices at the date of grant.

| **Weighted Average Exercise Price** | **Expiry Date** | **Number Outstanding** | **Number Exercisable** | **Weighted Average Remaining Contractual Life** |
|---|---|---|---|---|
| $ 0.25 | March 17, 2018 | 1,510,000 | 1,510,000 | 0.96 years |
| 0.20 | May 13, 2018 | 250,000 | 250,000 | 1.12 years |
| 0.21 | June 1, 2020 | 2,000,000 | 500,000 | 3.17 years |
| 0.21 | July 1, 2018 | 100,000 | 100,000 | 1.25 years |
| 0.15 | October 12, 2019 | 600,000 | 200,000 | 2.53 years |
| 0.15 | December 1, 2019 | 300,000 | 100,000 | 2.67 years |
| 0.17 | March 8, 2020 | 250,000 | 83,333 | 2.94 years |
| **$ 0.21** | | **5,010,000** | **2,743,333** | **2.09 years** |

(c) Share-based compensation

During the three month period ended March 31, 2017, the Company recorded share-based compensation totaling $39,000 (2016 - $70,100), which was expensed in operations with a corresponding increase in contributed surplus.

The fair value of share options was estimated on the measurement date using the Black-Scholes option-pricing model and is amortized over the vesting period of the underlying options.

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

| | **Three Months ended March 31, 2017** | **Year ended December 31, 2016** |
|---|---|---|
| Risk-free interest rate | 0.61 to 0.96% | 0.61 to 0.76% |
| Expected life of options | 3 years | 3 years |
| Expected volatility | 222.68 to 228.68% | 222.68 to 228.68% |
| Weighted average fair value per option | $0.11 to $0.15 | $0.11 to $0.13 |
| Dividend yield | Nil | Nil |

(d) Escrowed shares

At March 31, 2017, there are a total of 15,294,215 (2016 – 30,601,764) common shares subject to escrow restrictions. The escrow shares will be released in tranches every six months until February 18, 2018.

**12. 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 (deficiency), advances from directors and convertible debt. 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.

**13. Cost of sales:**

Included in cost of sales is inventory of $154,413 (2016 - $64,931).

**14. Government assistance:**

During the three months ended March 31, 2017, the Company received government assistance in the amount of $284,674 (2016 - $285,699).

**15. Change in non-cash working capital:**

| | **March 31, 2017** | March 31, 2016 |
|---|---|---|
| Decrease (increase) in trade and other receivables | **$ (168,433)** | $ (346,633) |
| Decrease (increase) in inventory | **325,630** | (251,626) |
| Decrease (increase) in prepayments | **(3,146)** | 7,863 |
| Increase (decrease) in trade and other payables | **390,605** | 250,173 |
| Increase (decrease) in deferred revenue | **217,144** | (176,837) |
| | **$ 761,800** | $ (517,060) |

**16. Segmented information:**

The Company operates in one reportable operating segment, being the design, manufacture and sale of underwater sonar and acoustic sensor equipment. The summarized financial information for revenue derived by geographic segment is as follows:

| | **March 31, 2017** | March 31, 2016 |
|---|---|---|
| Total revenues: | | |
| Germany | **$ -** | $ 423,278 |
| Israel | **246,498** | 195,722 |
| Other | **-** | 91,690 |
| | **$ 246,498** | $ 710,690 |

**17. Subsequent events:**

Subsequent to March 31, 2017, the Company:

(a) completed a non-brokered private placement of 11,806,660 units at a price of $0.18 raising gross proceeds of $2,125,199. Each unit consists of one common share and one half of one common share purchase warrant. Each full warrant is exercisable at a price of $0.30 for a period of two years. The Company paid cash finder's fees of $47,040 in connection with the placement;

**17. Subsequent events (continued):**

(b) was awarded a non-refundable financial contribution of $745,950 by the Research & Development Corporation (RDC) of Newfoundland and Labrador to support development of the Company's ThunderFish™ Autonomous Underwater Vehicle (AUV) program;

(c) has acquired a minority interest in ENITECH Subsea GmbH of Rostock, Germany and that company has been renamed Kraken Power GmbH. Under the agreement, Kraken has taken a 19.9% equity interest and provided a €110,000 convertible loan. The loan pays interest at 5% per annum and has a term of three years. Through the conversion of the loan to equity and a further investment capped at €200,000, Kraken can choose to increase its ownership stake to 75% of the common shares of Kraken Power GmbH;

(d) completed the sale of its investment in Square Robot Inc. (note 8), extinguishing a note receivable in the amount of $393,287 and realizing a gain of $327,384;

(e) issued 100,000 common shares upon the exercise of share purchase warrants for proceeds of $15,000; and,

(f) recorded the expiry of 200,000 incentive stock options priced at $0.25.